



Homi Kharas, Annalisa Prizzon
and Andrew Rogerson

Financing the post-2015 Sustainable Development Goals

A rough roadmap



Overseas Development Institute

203 Blackfriars Road

London SE1 8NJ

Cover image: clarividus (<https://www.flickr.com/photos/desarticulee/>): Flickr Photostream

The Institute is limited by guarantee

Registered in England and Wales

Registration no. 661818

Charity no. 228248

Contact us

odi.org

odi@odi.org.uk

T: +44 (0)20 7922 0300

Disclaimer

The views presented in this paper are those of the author(s) and do not necessarily represent the views of ODI.

© Overseas Development Institute 2014.

Readers are encouraged to quote or reproduce material for non-commercial use. For online use, please link to the original resource on the ODI website.

As copyright holder, ODI requests due acknowledgement and a copy of the publication.

Contents

List of tables, figures and boxes	3
Abstract	4
Abbreviations	5
Acknowledgements	5
Glossary of development finance terms	6
Executive summary	7
Summary of recommendations	9

Introduction	10
Report structure	10

Section 1: Global development finance	12
The 3 main elements of global development finance	12
What should development finance be used for?	13
A benign outlook for global savings mobilisation	14
Creditworthiness and access to private capital markets:	15

Section 2: Costing and resourcing the SDGs	17
Exploring trade-offs across goals and sources	17
National financing plans to integrate investment needs and financing sources	17
Why country context matters: examples of trade-offs across objectives, sources and time	18
Looking up from country level: the missing middle problem	18
Global thematic partnerships, their strengths and weaknesses	19
Policies for unlocking private financing for sustainable development	20
Volatility and complementarity of private and public sources	22
Towards a Market Aid Index – a first cut	23

Section 3: Development finance and country classifications	25
The problem with income-based classifications	25
The missing middle: international flows fall faster than tax revenues rise	26

Moving beyond classification based on income levels: fragility and domestic tax capacity	27
Section 4: Climate change and development finance: strange bedfellows?	30
A trade-off between growth and climate change mitigation and resilience?	30
Climate change and development finance: two silos?	31
Section 5: Institutional bottlenecks to be addressed internationally: reverse the erosion of non-concessional MDB lending	33
Section 6: Specific recommendations for change	35
1. Boost market-terms lending by MDBs (rationale as in Section 5)	35
2. Boost access to market-related public finance more generally	35
2A. Agree on a new international indicator for 'official finance' (OF)	35
2B. Set a new UN-agreed international target for OF	35
3. Incentivise private finance and align it with development objectives	36
3A. Agree on basic definitions and metrics for private finance for development (PFFD)	36
3B. Give explicit credit (including in ODA and/or OF) for undisbursed guarantees and other contingent commitments	36
4. Minimise the allocation distortions inherent in international public finance for climate mitigation	37
4A. Isolate public climate change mitigation finance from country aid budgets and finance it mainly with non-concessional instruments.	37
4B. Establish a new target for the share of concessional assistance for adaptation going to LDCs and SIDS	37
Section 7: Concluding remarks: balancing international public-private roles across and within countries	38
References	40
Annex 1: Methodology for analysis of evolution of development finance flows by income per capita	44
Annex 2: Methodology for Market Aid Index	47
Annex 3: Marginal tax rates	49
Endnotes	54

List of tables, figures and boxes

Tables

Table 1. Real GDP per capita growth 1960-2010 by quintiles of initial income distribution	13
Table 2. Gaps and priorities for enhanced private investment	21
Table 3. Capital flow volatility by source and country group (1995-2011) ⁶	23
Table 4. Top 20 countries FSF and gross ODA 2010-2012	32
Table A 1. Share of ODA to the private sector and OOF as a share of total official finance	48
Table A 2. Marginal tax rates	50

Figures

Figure 1. Finance flows and development goals	7
Figure 2. Market Aid Index	24
Figure 3. Country classification by income level	25
Figure 4. ODA, OOF and tax revenue as a share of GDP by per capita income	26
Figure 5. External flows as a share of GDP by per capita income	27
Figure 6. Distribution of ODA ratio (% GDP) by cluster coefficient of variation	28
Figure 7. Marginal tax rate - income per capita	28
Figure 8. Marginal tax rate by income group	29
Figure A 1. ODA Official Development Assistance vs GDP per capita	44
Figure A 2. Comparison other official flows and GDP per capita	45
Figure A 3. Comparison foreign direct investment and GDP per capita	45
Figure A 4. Comparison remittances and GDP per capita	46
Figure A 5. Comparison tax revenues and GDP per capita	46

Boxes

Box 1. The impact of low global interest rates on developing and emerging economies	15
Box 2. MDG options in the country context – the case of Uganda	19

Abstract

We regroup the main types of global development finance into three clusters: concessional public finance (including domestic taxes), public borrowing on market-related terms, and private finance. We look at the main purposes they can be used for, and their interdependence. We consider the global outlook for capital markets, the determinants of country creditworthiness and why grant aid should be prioritised for less creditworthy countries. We suggest that financing plans for most of the new Sustainable Development Goals should be developed at the country level rather than globally, so that key trade-offs can be fully explored. We look at specific policies to unlock access to private sector participation in five key areas – including social services. We introduce a Market Aid Index to help track donor engagement with the private sector.

We investigate how a country's mix of development finance changes as it grows – the so-called 'missing middle' dilemma. We find that public resources overall fall continuously until a country is well into middle-income status, as international assistance falls faster than tax revenues rise. Static per capita income thresholds are becoming increasingly unreliable guides to resource allocation. We look at alternative groupings, especially taking into account fiscal capacity, creditworthiness and vulnerability.

We assess the recent literature on trade-offs between rapid growth and climate change mitigation imperatives. We examine the geography of public climate finance, which is intrinsically different from that of development aid, and the lack of a credible 'additionality' test for funding the former over and above the latter. We therefore consider how the limited public grant element so far available should best be rationed, to limit the scope for distortions.

We revisit the role of the multilateral development banks' market-related windows, in view of the missing middle problem. We consider what factors underpin their secular stagnation, and how to overcome them. We summarise other specific international reform options in response to our analysis, on private sector contributions, market-related lending and climate finance. We conclude by contrasting two alternative world views: (1) making international public finance a complement to private finance everywhere, and (2) deliberately focusing public stakes where the private sector is not present. We suggest a way forward.

Abbreviations

ADB	Asian Development Bank	LDC	Least-developed Country
B20	Business Group set up to advise the G20 leaders' summit	LIC	Low-income Country
BRICS	Brazil, Russia, India, China, South Africa	LLDC	Landlocked Developing Country
CAF	Andean Development Cooperation	LMIC	Lower-middle-income Country
CIF	Climate Investment Funds	MAMS	Maquette for Millennium Development Goal Simulation
CPA	Country Programmable Aid	MDB	Multilateral Development Bank
DAC	Development Assistance Committee	MDG	Millennium Development Goal
FDI	Foreign Direct Investment	MIC	Middle-income Country
FSF	Fast-start Finance	NGO	Non-governmental Organisation
GDP	Gross Domestic Product	ODA	Official Development Assistance (see Glossary)
GHG	Greenhouse Gas	ODI	Overseas Development Institute
GNI	Gross National Income	OECD	Organisation for Economic Co-operation and Development
HDI	Human Development Index	OF	Official Finance (see Glossary)
HLP	High Level Panel	OOF	Other Official Flows (see Glossary)
IBRD	International Bank for Reconstruction and Development	PFFD	Private Finance for Development (see Glossary)
ICESDF	Intergovernmental Committee of Experts on Sustainable Development Financing	PPP	Purchasing Power Parity
IDA	International Development Association	SDG	Sustainable Development Goal
IFC	International Finance Corporation	SIDS	Small Island Developing States
IFI	International Finance Institution	TOSD	Total Official Support for Development (see Glossary)
IMF	International Monetary Fund	UK	United Kingdom
IPCC	Intergovernmental Panel on Climate Change	UMIC	Upper-middle-income Country
IPF	International Public Finance (see Glossary)	UN	United Nations

Acknowledgements

The authors are, respectively, Senior Fellow at Brookings Institution, Research Fellow at ODI, and Senior Research Associate at ODI. The report benefitted from substantial research inputs by Gideon Rabinowitz, Maya Schmaljohann and Christine Zhang. The authors are grateful to Owen Barder, Debapriya Bhattacharya and Dirk Willem te Velde for their insightful peer reviews

of the first full draft, and acknowledge other valuable comments and suggestions received from, among others, Romilly Greenhill, Edward Hedger, Paddy Carter and Scott Morris. Financial support for this report from the Bill and Melinda Gates Foundation and Development Progress is also gratefully acknowledged. The authors remain solely responsible for its content.

Glossary of development finance terms

Concessional Assistance: official public support on terms that can run from 100% grant to marginally better than market loan rates, and anywhere in between. We use it here to refer to the grant end of the spectrum, as distinct from market-related public borrowing (below).

Concessional Public Finance: our term, combining domestic tax revenues and concessional assistance.

International Public Finance (IPF): a recently introduced umbrella term, combining (1) all development cooperation, very broadly defined, and (2) official international support for other primary public purposes, such as export promotion and climate change mitigation. Both can be supplied on more or less concessional terms, as above.

Market-Related Public Borrowing: loans, in this paper mostly at the harder end of the concessional spectrum, taken or guaranteed by sovereign borrowers in developing countries. The lenders are mostly public bodies, such as MDBs, export credit agencies and sovereign borrowing on commercial terms from banks and capital markets. Their rates should, and generally do, compare favourably to the lowest market yield at which the borrower can place its bonds or syndicated private loans.

Official Development Assistance (ODA): The set of standards adopted by members of the OECD's Development Assistance Committee (DAC) for counting development 'aid', also used for voluntary reporting by some other countries. Includes a country eligibility list, rules for scoring development-related expenditure within donor countries, and thresholds for the inclusion of concessional loans. All three elements are under review and changes are expected shortly.

Official Finance (OF): Our term for global, UN-based tracking of OOF-like flows (see below) from all sources and purposes, whether they agree with ODA (and other DAC) definitions or not. Inclusion is subject only to the test that financial terms plausibly improve on the best market alternative available.

Other Official Flows (OOF): The face value, under current ODA definitions, of official loans reported to the DAC that do not qualify for ODA, either because they fail the ODA concessional test or because they assert other primary purposes than development.

Private Finance for Development (PFFD): Private financial flows directly associated with a significant public investment (concessional or market-related), including through equity stakes, loans, and guarantees and related instruments.

Total Official Support for Development (TOSD): A new aggregate recently proposed by the DAC, to capture most of IPF which would not qualify for ODA under its new definition as above. In particular, assuming that revised ODA counts only the grant equivalent of loans, TOSD would score the difference between that element and their face value (hence OOF would disappear as a separate category in DAC reporting).

Executive summary

This report looks ahead to major UN-hosted international meetings on development finance in 2015 and beyond, and is intended as a briefing for officials, advisors, commentators shaping the agenda there. Of some 190 countries attending, perhaps 30 have long been, and will likely remain, chronic ‘donors’ through 2030, and up to another 30 are likely to remain chronically ‘aid’-dependent through that horizon. However, a whopping 130 or more fit into neither category: if that crushing majority is not convinced they have a real stake in the proposals put forward, nothing of lasting value will occur.

The paper builds upon a large body of recent literature on how the Sustainable Development Goals (SDGs) should best be framed, delivered and, in particular, funded, focusing on developing countries. It identifies a few key pressure points on which additional international action is both desirable and realistic. Our premise is that governments have relatively little control over the private actors who will largely determine the pace of progress toward the SDGs: they have influence of course, but must use that effectively and consistently.

It acknowledges, but does not repeat, much of the ‘policy coherence’ or ‘means of implementation’ debate. Policies and finance can be both complements and substitutes in achieving goals. However, too much rhetoric on what developing countries should do for themselves can distract attention from the necessary contributions of advanced countries, whether in terms of their own policies or the resources they need to deploy. ‘Where is the money?’ remains a revealing enough question in its own right, even if answering it is far from sufficient to achieve the SDGs. Our main concern is also not with either public finance or private finance taken individually, but in the interplay between them, and how to make the most of their relative strengths.

Our analysis starts with the helpful, though not airtight, grouping of development spending needs used by the Intergovernmental Committee of Experts on Sustainable Development Financing (ICESDF) into those relating mainly to: (1) basic needs and social progress; (2) infrastructure for sustainable development; and (3) global public goods, under which heading we consider mostly climate change mitigation here. We also share ICESDF’s perspective that global public and private savings should be sufficient in aggregate to meet the needs for all three categories of investment, especially in a globally favourable capital markets setting. However, some current financing and investment patterns will need to change, and this shaping will not occur spontaneously.

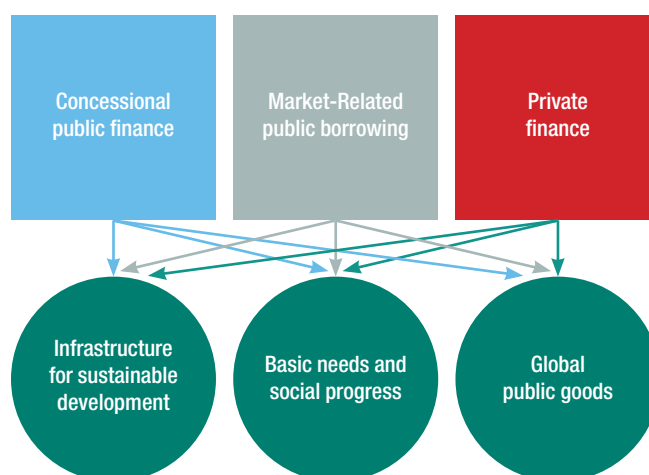
We group (Figure 1 below) the types of finance available to developing countries also into three: (a) concessional public finance; (b) market-related public borrowing; and (c) private finance. The first category includes both

domestic tax revenue and international concessional assistance (see Glossary). The second includes developing government borrowing on market-related terms from public and private intermediaries, with a special emphasis on terms that improve significantly on the best available market offer. The third includes all other private finance.

We use this particular combination to highlight the links between domestic taxes and aid, as well as the role of public borrowing on market-related terms in a global environment of low real interest rates. We choose not to differentiate between domestic and international private finance. The policies to mobilise private finance and the potential interactions with public finance are similar in both cases.

We take a country perspective, considering creditworthiness and fiscal capacity, in particular, as

Figure 1. Finance flows and development goals



critical overlays to the increasingly unhelpful income-based classifications that still dominate many development aid allocation rules. This perspective also spotlights the need for assistance for rule-of-law improvements as a route towards opening up greater financial market access. And it strengthens the case for giving special consideration to least developed countries (LDC) and small island developing states (SIDS), classifications which are also strong predictors of low creditworthiness.

We look at funding sources available to countries at different stages of their growth. We find a clear ‘missing middle’ pattern, whereby just as many countries start to emerge from very low income, their growth is constrained as domestic taxes and foreign private and market-related public borrowing all fail to expand fast enough (and some to expand at all) to compensate for concessional assistance.

The latter simply falls too quickly in relation to desirable public development investments.

The inclusion of global public goods centre-stage in the new SDG framework calls for another major set of adjustments to development policies and programmes that have traditionally taken single countries as their main, if not sole, reference point.

The key case in point is climate change mitigation, which unlike adaptation is a global, as well as regional, public good. We endorse recent analyses emphasising the synergies at global level, or conversely the lack of major trade-offs, between switching to resilient national growth pathways and eradicating absolute poverty. Nonetheless, a significant subset of very poor countries lacking financial market access could rationally take a different view, based on higher discount rates than those prevailing globally, on their critical investment choices. We also draw attention to the geography of public mitigation finance, sourced largely from aid budgets so far, but which, unlike the geography of development aid, is heavily skewed toward emerging economies that are large carbon emitters.

Given the sheer scale of climate mitigation investment needs, the broadly favourable capital market context and the negligible impact of all but a handful of developing countries on the global carbon footprint, grant aid for climate change should be reserved as far as possible for adaptation. This is to preclude diversion of grants to middle-income countries, in the likely event that large-scale ‘new and additional’ concessional assistance resources are not in fact raised for mitigation for some years to come. Adaptation funding should meanwhile continue to target those most vulnerable to climate change, notably LDCs and SIDS, for whom we propose a new international threshold of 50% of public concessional adaptation assistance. To the extent that grants are provided for mitigation, they should be used for demonstration

purposes in less developed/less creditworthy countries, with market-related publicly intermediated loans, at current low interest rates, leveraging private resources for the rest.

The two strands of our analysis, country-based priorities and global public goods, therefore converge towards the following recommendations: (1) for concessional assistance, redirect this finite resource towards less creditworthy countries, which have relatively more need for it and where it could over time help unlock market access; (2) for market-related public borrowing, raise far more of it, especially through the multilateral banks (MDBs) that are under-serving some key constituencies; and (3) for private finance, level the playing field, reduce distortions across uses and unblock regulatory obstacles to wider access. This third track calls for policy changes as well as blending of public and private funds in specific projects and partnerships.

There remains a final underlying tension to be resolved in the deployment of scarce public international finance, between the polar options of (a) spreading it very thinly and widely in systematic association with private flows, or instead (b) resolutely concentrating only on contexts and uses where private flows are absent or grossly insufficient. We suggest that grant-heavy assistance be concentrated on the least creditworthy countries, but used within them as far as possible to enable or crowd in other flows.

Finally, we suggest a few modest and targeted institutional improvements, starting with a more joined-up approach to using the balance sheets of the MDBs, but also better metrics and targets for market-related official finance (OF) and for leveraging the private sector, including via guarantees. We illustrate the latter problem with a crude ‘index of market aid’ comparing the extent that different bilateral programmes engage with the private sector today.

Summary of recommendations

<ul style="list-style-type: none">• Boost market-related lending by MDBs.	<ul style="list-style-type: none">• Independently review demand for market-related MDB financing.• Leverage receivables of concessional windows.• Smoothen graduation from concessional to market-related windows.• Improve competitiveness of MDB delivery.
<ul style="list-style-type: none">• Boost access to market-related public finance more generally.	<ul style="list-style-type: none">• Agree on a new international indicator for 'official finance' (OF).• Set a new UN-agreed target for OF.
<ul style="list-style-type: none">• Incentivise private finance and align it with development objectives.	<ul style="list-style-type: none">• Establish basic metrics for private finance for development (PFFD).• Recognise undisbursed guarantees and other contingent finance.
<ul style="list-style-type: none">• Minimise allocation distortions inherent in public climate mitigation finance.	<ul style="list-style-type: none">• Finance mitigation mainly on market-related loan terms, with grants for demonstration programmes in less creditworthy countries.• Establish a new floor of 50% for the share of concessional assistance for adaptation going to LDCs and SIDS.
<ul style="list-style-type: none">• Balance public-private roles across and within countries.	<ul style="list-style-type: none">• Prioritise concessional assistance across countries to the least creditworthy, with lowest tax capacity and greatest vulnerability.• Within these countries, crowd in private actors via partnerships and rule-of-law support.• Mobilise far more market-related public finance, and encourage greater leverage of private finance in specific sectors, in countries with good market access.

Introduction

This report looks ahead to major international meetings in 2015 and beyond and is addressed to actors shaping the agenda there. It aims to identify a limited menu of recommendations for change that could be agreed collectively at those meetings. Finding space for agreement among 190-plus countries, of which the vast majority do not self-identify with terms like ‘donor’ or ‘recipient’, will not be easy. It builds on a burgeoning literature¹ that converges on a likely new set of international Sustainable Development Goals (SDGs) and asks what must be done to implement them, including how best to fund them.

It tries to boil down the complexity and interdependence of these questions to a few key pressure points on which action at the international level is both desirable and realistic, in a multipolar world relying largely on the limited prospects for consensus decision-making among governments. There is an equally limited ability of governments to shape incentives to drive the actions of private businesses and households, where most of the real actors are.

It is aimed at generalist policy-makers and delegates and the wider community of practitioners, commentators and analysts who stand behind them. It does not presume specialist knowledge. Where our findings rely on our own empirical work, our methods are explained as far as possible in annexes or boxes so as to keep the narrative flowing.

We use the term ‘roadmap’ to refer to the pathways between three clusters of funding sources and three types of development finance, as summarised below. We also differentiate between country contexts, especially in terms of their varied access to market-based finance. We call this map ‘rough’ because it is simplified, for sure. Some may find it grossly oversimplified: we make no apologies on this account. The true landscape out there is multidimensional and constantly changing. We hope readers will be able to fill in some of the relevant extensions and updates for themselves, starting from this stylised base.

A second warning is in order. We understand how improved policies (domestic and international) can be close substitutes for, as well as complements to, additional finance. This is particularly true with respect to the effectiveness and efficiency of public spending. So we acknowledge the huge ‘Policy Coherence’ or ‘Means of Implementation’ agendas, going well beyond finance, and indeed as key enablers of finance.

Nonetheless, we devote relatively less space to these agendas here than do others we cite, partly to avoid repeating advice that is sound but not readily actionable. We also believe too much global emphasis on what developing countries could or should do for themselves is intrusive and unproductive, especially if it is seen as

deflecting attention from the contributions of others, in cash or policy change from their side. Finally, we suggest that ‘finding the money’ is an important enough consideration in its own right, though of course far from sufficient by itself to reach any given goal, let alone the whole set.

Report structure

Section 1 looks at the three main components of global development finance, the purposes they can be used for and their interdependence, across different country types and areas for investment. This section also considers the favourable global outlook for capital markets, which powerfully shifts investors’ calculus, including in favour of green technology. It examines the determinants of country creditworthiness and why and how aid should be prioritised to less creditworthy countries, many of which are least developed countries (LDCs) and small island developing states (SIDS). We return to country classifications, and especially tax capacity, in Section 3.

Section 2 argues that costing and financing plans for the new SDGs should be developed at the country level rather than globally, so that key trade-offs across objectives and funding types can be fully explored. It looks at policies to unlock access to private sector participation in five key sectors. It reminds us of the importance of reducing volatility for both private and public flows. And it introduces a Market Aid Index to help track donor engagement with the private sector, illustrating how difficult it is to measure inputs of public support to the private sector consistently – let alone its impact.

Section 3 concludes our analysis of changing country-based needs. We look at how a country’s mix of development finance changes as it grows – the so-called ‘missing middle’ dilemma. Overall public resources fall initially, as aid falls faster than tax revenues rise, and private international flows do not close the gap at lower-middle income levels. This also flags the chronic inadequacy of market-related official lending to ‘graduating’ countries. Static per capita income thresholds are becoming increasingly unreliable guides to resource allocation. We look at alternative groupings, especially taking into account fiscal capacity and vulnerability, as well as creditworthiness, as above.

Section 4 moves from country-based development approaches to how they will have to adjust to the SDGs’ global imperatives. It revisits, as a critical illustration of this adjustment, the debate on trade-offs between rapid growth and mitigation imperatives. It likewise reviews the geography of public climate finance, which is intrinsically different from that of development aid, and probes the

limits of the ‘additionality’ question. It considers how the limited concessional public finance available (so far) should best be rationed, consistent with our approach above on creditworthiness and the residual case for public intervention in markets.

Section 5 revisits the role of the multilateral development banks (MDBs), and in particular their ‘harder’ or market-related windows, in terms of what their contribution to the missing middle dilemma has been, and may yet be. It considers what factors underpin their secular stagnation, and how to overcome them.

Section 6 summarises four specific areas of international reform that are judged both targeted and feasible, based on the analysis of the preceding sections. In addition to MDB systemic reform, they include: a new metric and target for market-related lending; better metrics for private finance mobilised by deliberate public action; and limits of the use of concessional assistance for climate change mitigation in creditworthy countries, along with specific preferences for LDCs and SIDS for adaptation.

Section 7 concludes by contrasting two mutually incompatible world views: (1) make international public finance a complement to private finance everywhere, and (2) deliberately focus public stakes only where the private sector is not present. We suggest a pragmatic way forward.

Section 1: Global development finance

Summary:

We consider the three main types of development finance, the purposes they can be used for and their interdependence. Of these, the international component of concessional public finance remains the most valuable for developing countries, in that it has the fewest trade-offs and is potentially the most flexible in use. This section also considers the global outlook for capital markets, which we expect to remain liquid and low cost for the next decade or more. This outlook encourages investment activity in general and especially for those investments with higher upfront costs and longer-term benefits (such as renewable energy). We also suggest that more countries will have regular access to commercial private finance. The section then examines the determinants of country creditworthiness and the reasons why aid should be prioritised to less creditworthy countries (for which the LDCs and SIDS categories prove to be good predictors) and targeted at improving their market access over time through rule-of-law improvements.

The three main elements of global development finance

The Intergovernmental Committee of Experts on Sustainable Development Financing (ICESDF) usefully broke down development finance into four components, consisting of domestic and international, public and private finance. We regroup them into three: (1) concessional public finance (grant assistance and taxes), (2) public borrowing on market-related terms (with a particular focus on loans from public institutions on better-than-market terms), and (3) private finance (see Figure 1 and Glossary).

We do this mainly, first, to draw attention to the synergies between taxes and aid; second, to highlight the underutilised potential of public loans on ‘harder’ terms in a favourable global capital market context. We do not differentiate between international and domestic private finance, as both the policies to help mobilise them and their interactions with public finance are broadly similar.

Concessional public finance

The domestic public revenue component (taxes and royalties) that concessional assistance seeks to supplement has grown rapidly overall because of the acceleration of the tax base in developing countries (general economic growth). Furthermore, in many low-income countries (LICs), growth has been jump-started by natural resource extraction, and these projects make a particularly large contribution to public revenues. Given likely exploitation of new mineral discoveries, these revenues will continue to expand as long as commodity prices do not fall

precipitously. The International Monetary Fund (IMF) identifies twenty resource-rich economies in sub-Saharan Africa (those where resources account for over a quarter of total exports) and half of these are also fiscally dependent on natural resources (resource revenue more than 20% of total revenues). The issues are managing the volatility and sustainability of these revenues over time to avoid the resource curse (Lundgren et al., 2013).

The *concessional assistance* component of concessional public financing has also grown significantly, in absolute terms at least. Concessional assistance or more loosely, aid (in the sense of grants in particular) has a special place in financing development as it is the only revenue source with minimal economic trade-offs. Unlike raising taxes, aid does not cut profits and growth in recipient countries. Unlike international or domestic borrowing, grant aid does not create future debt problems. Unlike remittances, aid can potentially be spent directly on important public goods like police, judiciary and public administration. To most effectively achieve its objectives, aid can be channelled through government, non-governmental agencies or businesses, and it can be targeted at groups and areas that may not easily be able to attract other funding (even redistribution via the tax system, which has inherent limits). It is, therefore, potentially the most valuable of all sources of development finance from the perspective of the recipient government, assuming of course that donors and governments behave accountably and effectively and do not restrict aid’s flexibility through unnecessary earmarks.

Concessional assistance (grant aid and concessional loans) from all donors spent in developing countries (so-called country programmable aid, CPA) rose from \$63 billion in 2000 to \$93 billion in 2012. But CPA to least developed countries (LDCs) and other LICs more than doubled (from \$19.4 billion to \$40.4 billion), while aid to upper-middle-income countries (UMICs) actually declined slightly. Aid to lower-middle-income countries (LMICs) was broadly static, though not keeping up with population growth. Thus, the growth of aid to LICs has come about from a reallocation of aid away from relatively richer countries as well as from an expansion in the overall level of aid. Each factor has been equally important. Looking ahead, prospects for substantial additional CPA are not promising, but the continued rapid graduation of many developing countries out of LIC and LMIC categories does imply that a process of reallocating aid towards LICs can provide a reasonable growth of aid for those countries most in need.

The principles that should guide this reallocation of aid are currently being debated. Broadly speaking, the principles drive two decisions: whether and how to allocate aid across countries (with income level being the dominant

variable currently used – at least in theory – together with additional focus on fragile states, LDCs, SIDS and historical relationships or friendships); and the purposes to which aid should be put. Aid has always been construed as primarily for development, now broadly interpreted to include global public goods like climate change mitigation, which affect both developing and advanced countries. However, some activities with significant development purposes, like peacekeeping or guarantees, are not today fully counted as aid, while other activities with little impact on poor countries' development, like scholarships and refugee costs in donor countries, are counted. These two issues, of country and purpose allocation, are linked. If aid were allocated more to climate change mitigation than to primary education, for example, it would also go more towards large middle-income-countries (because of the size and structure of their economies and public service coverage) as compared to fragile states and LICs. Below, we argue that a dynamic reallocation of aid using a creditworthiness criterion would be a useful new instrument to consider.

Public borrowing

The second leg of this stool of development finance is public borrowing on market-related terms. This comes mainly from bilateral and multilateral development banks and agencies, especially on better-than-market terms, but it also includes regular syndicated loans and sovereign bond issues, on domestic and/or international markets. Many developing countries have fiscal space to borrow more as a consequence of rapid growth in gross domestic product (GDP) and exports, a build-up of foreign exchange reserves, improvements in the rule of law, and sound macroeconomic policy with low rates of inflation. Several have also benefited from debt relief. But there have been constraints on the supply side of MDBs and other official lending agencies (see Section 5), so this pillar of the international financial architecture has been stagnant since the early 1980s in nominal terms. The debt crises of many countries in the 1980s and 1990s have led to the application of credit rationing based on the results of a mechanical Debt Sustainability Framework model that may be excessively restrictive by not differentiating between capital and recurrent public spending, and the corresponding multipliers, for example. In fact, over time, it is LMICs (the second lowest quintile of countries) that have both received the lowest levels of capital inflows and registered the least rapid growth of GDP per capita. Aid cut-offs as countries become richer seem to have significant consequences for growth and development (Galiani et al., 2014). This issue appears to be most serious in the second quintile of developing countries (Table 1). We analyse this further in Section 3.

Table 1. Real GDP per capita growth 1960-2010 by quintiles of initial income distribution

	Mean real GDP per capita growth 1960-2010 (percent per year)	Standard deviation	Number of countries
Poorest quintile	2.2	2.0	22
Second quintile	0.9	1.5	22
Third quintile	2.0	1.6	22
Fourth quintile	2.4	1.2	22
Richest quintile	2.1	0.6	22

Source: Penn World Tables Version 7.0.

Note: Table 1 reports summary statistics on average growth performance from 1960 to 2010 for 110 countries, grouped by quintiles of the initial income distribution in 1960, updating calculations by Easterly (2006). Table reproduced from Table 1 in Kraay and McKenzie (2014).

Private finance

The third leg, of domestic and international private finance, has grown rapidly in aggregate volume, and many more countries are destinations as well as sources of these funds. While definitions of what to include in private international finance vary (for example, remittances can be classified either as private philanthropy or as a factor export), it is safe to say that private finance has gone from an insignificant feature of the financing of LICs to a dominant feature. In fact, 12 LICs receive more from foreign direct investment (FDI) than from aid. Of course, private financing does not automatically have sustainable development objectives at its heart, with safeguards for social and environmental impacts, but it does provide jobs, growth and economic opportunities when allowed to operate in a well-regulated and relatively undistorted environment. A priority is the provision of incentives or regulations so that private businesses contribute to sustainable development outcomes to the maximum potential in major sectors like extractives, infrastructure, agriculture, banking and social impact investing. And when substantial private inflows relax the balance of payments constraint facing a country, it is easier for the public sector to increase expenditures through running moderately higher deficits without facing a high risk of an exchange rate crisis.

What should development finance be used for?

The **three core purposes** for which development finance is required are described by ICESDF as (1) financing for basic needs related to ending poverty and hunger, (2) financing for sustainable development investments, notably infrastructure, energy, resilience and rural development, and (3) financing for global and national public goods.

In each category, there is significant under-funding, in the sense that desirable development spending on projects and programmes that yield marginal benefits greater than marginal costs is not yet undertaken. ICESDF concludes that ‘it is clear that current financing and investment patterns will not deliver sustainable development’. In discussing the potential for additional financing, ICESDF also notes the interdependence between various financing streams. As examples, domestic public finance can be helped by targeted support in the form of capacity-building through aid (international public finance) or by the increased revenues associated with economic growth generated by FDI; private finance, both domestic and international, can be catalysed by aid in public-private partnerships and other mechanisms.

Each component of external financing has its own characteristics and drivers, but increasingly there are substantial interdependencies among them, resulting from a changing context of global development and finance. Financing needs and challenges are highly context specific, but structural changes have altered the nature of developing countries’ needs.

Most developing countries have had significant success in raising tax revenues for their own public expenditures. But there are still shortfalls in basic needs spending (mostly within LICs), with 31 countries spending less than \$200 (2011 purchasing power parity, PPP) per person per year on health, education and other public services. Partly, this is because governments tend to provide more collective goods (administration, defence, public order and safety, environmental protection) at early stages of development before turning to service delivery. For a typical country in Africa, public services comprise half of government recurrent spending.

Gaps in public investments for sustainable development (mostly within MICs) are also sizeable. Despite both enthusiasm for, and some controversy over, infrastructure public-private partnerships, two thirds of infrastructure financing comes from public sector treasuries (Bhattacharya et al., 2012). Even in advanced countries, over half of infrastructure is financed by governments.

It is not self-evident, however, that there is abundant global funding potentially available for the SDGs, even before discussing under what conditions it gets allocated for the ‘right’ balance of purposes and countries. So we next discuss the foreseeable capital markets context into which the SDGs will be launched.

A benign outlook for global savings mobilization

Structurally, it appears that global capital markets are entering a protracted period of high liquidity, low cost and a modest risk premium which could last a decade or more, even with a tapering of quantitative easing policies. The ‘secular stagnation’ theory that has gained considerable

traction can be reframed as an environment where negative real interest rates are required to equate saving and investment and permit full employment (Teulings and Baldwin, 2014). These features favour developing countries that have, as suggested above, substantial needs for higher spending and accelerating aggregate demand.

Analytically, the levels of real interest rates depends on saving, investment and the supply of and demand for risk-free assets. Recent developments in each of these three components suggest that low (or negative) real rates can be expected to continue for several years, albeit with risks of instability (see Box 1).

Global saving is rising because an aging population in advanced economies is trying to accumulate funds to ensure adequate consumption into the future (Loayza et al., 2000). Meanwhile, the average saving rate in emerging and developing countries has also risen, from 23% to 33% of GDP between 1990 and 2010, although much of this rise was concentrated in China.

At the same time, investment has dipped below 20% of GDP in advanced economies since the Great Recession, reflecting the continued gap between potential and actual output growth, and has only expanded in developing countries in line with savings (Lagarde, 2014). In addition, the IMF has highlighted the constraints posed by inadequate infrastructure as an obstacle to further private investments and growth.

The supply and demand for risk-free assets also suggests low levels of equilibrium real interest rates. The supply of global risk-free assets has been cut by half, with e.g. Spanish and Italian government bonds as well as asset and mortgage backed securities no longer qualifying. Meanwhile, regulators have forced banks, insurance companies and pension funds to increase their holdings of risk-free assets for prudential reasons. The result: higher prices and lower real interest rates on risk-free financial assets.

It is because of the potential that exists for many more developing countries (and official aid agencies) to tap into global capital markets at relatively low real rates that hybrid financing structures – linking grant aid or non-concessional lending from international finance institutions (IFIs) with tax money and with private commercial funds in public-private partnerships – have become so attractive. Such structures are still emerging, but offer the best prospect for financing sustainable development and infrastructure investments in the post-2015 period. We explore some of the institutional reforms that would facilitate this further in Section 5.

Another implication of a relatively long period of low real interest rates is that it justifies, through a standard financial cost-benefit lens (let alone social discounting), investment profiles with a relatively heavier upfront cost and long tails of lower operating costs. These profiles typically apply to renewable energy sources, for example, that have become financially cheaper relative to more

Box 1. The impact of low global interest rates on developing and emerging economies

- Nominal interest rates could rise with inflation even if real interest rates remain low or negative. It is, however, unlikely that inflation will increase significantly in the medium term. Commodity prices are falling as more supply comes on stream and wage growth is stagnant. Inflation is below both the policy target and the long-term expected rate in most advanced economies. Until output is able to return to its potential, an increase in inflation from the current average of about 1.5% will be slow (IMF, 2014a).
- Long periods of low or negative real interest rates could trigger asset bubbles. Indeed, there is speculation and controversy as to whether this is already under way – US auto loans, London and Chinese property, gold and art have ‘bubbly’ aspects. Given the damage caused by the sub-prime bubble in the United States, central banks had considered the wisdom of using monetary policy in a pre-emptive way to address asset bubbles, but this view does not seem to have gained much traction. Chair Janet Yellen of the US Federal Reserve has argued that macro prudential regulations should be used instead, keeping the focus of monetary policy on inflation, unemployment and the output gap (Yellen, 2014).
- Notwithstanding this benign environment for global interest rates, there is a concern that volatility in private flows could be destabilising for developing countries. Already, a ‘fragile five’ (Brazil, India, Turkey, Indonesia, South Africa) has been identified as potentially vulnerable, but the consensus view is that this vulnerability stems as much from domestic macroeconomic policy management as from global instability. Indeed, foreign investors increasingly hold local currency denominated bonds in developing countries, and almost 80% of government debt is funded through local financing (IMF, 2014b). Maturities are also lengthening as long-term pension funds and insurance assets in developing countries have now reached over \$5.5 trillion (Canuto, 2014).
- Of course, instability in private capital flows could also arise from a systemic crisis in the global financial market, but this threat is receding. The introduction of the Single Rulebook, the Single Supervision Mechanism and the Single Resolution Mechanism in the eurozone lessens the potential systemic risk from a eurozone bank failure (EC, 2014), but the risk that a large ‘too-big-to-fail’ bank could trigger another crisis cannot yet be disregarded. From the perspective of developing countries, few of whom are represented in the Financial Stability Board, the issue of international prudential regulations is too important to be left simply to G20 and a few other members and international organizations. Providing them with greater voice, including through enhanced discussions in the FSB’s regional consultative groups, is needed
- Similarly, the changes in capital adequacy, liquidity standards, and systemic risk and interconnectedness introduced by Basel III should reduce risk-taking by banks across the world. There is some danger that this could prejudice the willingness of banks to lend for investment projects in developing countries – Basel III gives incentives to banks to issue mortgages and short-term loans rather than long-term corporate and project finance loans, although there is no clear evidence that one type of lending is more risky than the other (G30, 2013). A number of policy changes could help restore a level playing field to long-term finance, such as creating new long-term investment intermediaries, developing domestic debt and equity capital markets, and removing regulatory biases towards short-term lending.

carbon-intensive technology in the current global capital market environment. We turn to this topic in Section 4.

However, the mere availability of savings and liquidity at global level by no means guarantees easy and regular access to them by all developing countries, let alone on terms they consider accessible or sustainable. We turn to this question now.

Creditworthiness and access to private capital markets: how to improve it

Seventy-four developing countries now have a credit rating that allows them to borrow in international capital markets. Twenty-one developing countries have an investment grade rating. For any developing country government, the benefit of receiving a grant or other form

of public international finance can be thought of relative to the next-best alternative, namely borrowing from capital markets (put another way, the benefit to a recipient country government of a one-dollar grant is the shadow price of foreign exchange). The less the access to capital markets and the higher the cost, the greater is the value to the recipient country government of a grant or a concessional public sector loan.

Some developing countries have taken advantage of high liquidity in global capital markets to issue long-term bonds – Ghana, Senegal and Zambia have all issued bonds at interest rates of 800 basis points or more, suggesting they have high shadow prices for foreign exchange. The history of these ventures has not been good: Standard and Poor’s reported that about half of all developing countries issuing bonds between 1980 and 2000 had at

least one debt crisis episode (Jahjah and Yue, 2004). It would be preferable for these countries to be able to access more concessional assistance and public market-related lending facilities, which are able to transfer funds at far lower rates. For example, current International Bank for Reconstruction and Development (IBRD) rates for 10-year flexible spread loans have an interest rate of just 0.73% (0.33% London Interbank Offered Rate (LIBOR) rate plus 0.4% spread), far lower than the rates countries are paying in global capital markets. In Section 5 we ask whether some countries are voluntarily making this seemingly irrational choice to borrow from capital markets rather than official multilateral banks, or whether they are being forced into it.

In the current (relatively) benign environment for global capital, grant-heavy official development assistance (ODA) should be focused on those countries that have little access to, or face high costs in, private capital markets (Kharas, forthcoming). This kind of allocation rule would give greater emphasis to LDCs and SIDS compared to the commonly used alternative allocation rule focusing largely on prioritising lower per capita income levels. It would also favour those economies that have yet to jump-start rapid growth, and countries with high external or domestic government debt.

The analysis (Kharas) also finds that variation between countries in terms of the rule of law is among the most important determinants of their access to private capital markets. This suggests a priority should be placed on reforms in this area.

Another alternative is for developing country governments to tap their own financial markets by raising domestic debt. This avoids the problems with foreign exchange mismatches that have caused or aggravated many external debt crises. Until recently, these domestic debt markets were non-existent or small in most developing countries, but they have now expanded and are likely to continue growing strongly.

Domestic borrowing by governments, however, to expand public spending may crowd out domestic private sector borrowing needs. So non-governmental channels of international financing are needed as well. Mostly, this will come through the private sector looking abroad – banks borrow from their foreign counterparts, corporates access FDI, households receive remittances from abroad. In this way, even private-to-private external flows can indirectly contribute to domestic development financing for the public sector, by making it possible for the public sector to borrow from domestic sources without reducing growth.

We now turn to how to promote comprehensive financing strategies in the national, sectoral and global contexts.

Section 2: Costing and resourcing the SDGs

Summary:

Costing and financing plans for the new Sustainable Development Goals need to be set firmly in a country context, so that key trade-offs – such as funding more infrastructure or social services at the margin or the interplay between foreign investments, taxes and public sector wages – can be fully explored. (The exception is goals and targets concerned with global public goods, like biodiversity loss.) We look at why global partnerships to mobilise resources have been relatively successful in the case of the first SDG cluster (basic needs), less intrinsically relevant for sustainable infrastructure investments, and problematic for global public goods. We look at specific policies to unlock access to private sector participation in five key sectors including, social services. We revisit the importance of reducing volatility, which remains high for grant-heavy aid as well as for FDI. And we introduce a Market Aid Index, to begin to track the intensity of donor engagement with the private sector.

Exploring trade-offs across goals and sources

One purpose of setting global development goals is to assess the adequacy of resources that can be mobilised for the task at hand and to advocate more funding if it is needed. A strategy for achieving each goal or target is credible only if it spells out what is needed in terms of financing, capacity-building, innovation, policy change, technology adoption and other means of implementation. During the course of implementing the Millennium Development Goals (MDGs), global partnerships were developed to advocate for resources in health, food security, education, and maternal and child mortality. Considerable effort was devoted to costing the MDGs on a goal-by-goal basis and to putting in place new initiatives when it became apparent that targets were not being met because of lack of resources. This sector approach worked particularly well in raising funds for global health initiatives, although the impact on funding for other sectors, such as education and food security, was far lower.

There are, however, questions about whether such an approach is suitable for the more comprehensive and complex set of SDGs that are expected to be adopted. The United Nations (UN) Open Working Group builds

on the tradition of MDG costing in proposing targets for financing under each goal (although without specific figures for the time being), while ICESDF reports on orders of magnitude of selected investment needs, taken from the literature. This shows that infrastructure, energy and climate change mitigation and adaptation are each likely to require orders of magnitude larger investments than the MDGs as we know them now. Nevertheless, the conclusion of ICESDF is that sufficient global savings exist, so the emphasis needs to be on shifting, even in a small way, the allocation of resources between purposes, and focusing on maximising flows from all sources to developing countries, rather than simply trying to maximise concessional flows. Given the global savings-investment context, we share this conclusion, and argue for additional financing to developing countries, preferably intermediated through official development agencies.

If larger flows of equity and debt could be mobilised for developing countries, it would permit them to expand investment in sustainable development, and to run modest current account deficits without unduly sacrificing current consumption. As a rough guide to orders of magnitude, a 3% of GDP average annual current account deficit for developing countries would require financing of about \$1 trillion in 2015-16, and would be sustainable in the sense of keeping long-term debt levels at less than 60% of GDP.²

What might country financing strategies look like and what kinds of trade-offs should they be considering?

National financing plans to integrate investment needs and financing sources

A country-level financing diagnostic approach may be useful, in addition to global sector approaches, as a way of understanding the spending and financing inputs to achieve the SDGs (Gable et al. 2014). One reason is that financing and investment programmes are highly context specific and depend crucially on the macroeconomic, policy and institutional environment in individual countries. With targets specified in terms of outcomes, the efficiency with which resources are used, the results orientation, is also a critical variable.

A national-level financing diagnostic permits governments to take into account a range of

considerations, including within-country inequalities, vulnerabilities, linkages between targets, and macroeconomic management. It can also integrate the three types of development financing discussed above into a consistent package.

One tool for understanding where financing gaps might exist, and the space for incremental spending, is the World Bank's Maquette for MDG Simulations (MAMS). MAMS brings to the fore issues of Dutch disease, absorptive capacity, and synergies between targets.³ It also breaks down gross national income (GNI) into its component parts of government, household and business income – an important distinction as each group contributes differently to spending for sustainable development: households along with government spend on meeting basic needs; governments on their own fund public goods; while governments and corporations finance investments in energy, connectivity and other economic activities to support national sustainable development.

Importantly, MAMS also provides a way of tracking deficits and debts over time to ensure that the financing plan is viable over time with properly sequenced and phased spending. Assessments of country creditworthiness and government indebtedness can also be carried out using the macroeconomic aggregate variables generated by the model.

Models permit more systematic identification of trade-offs. In applying MAMS to various countries, key trade-offs have been identified in the following areas: (1) the composition of public spending between growth-enhancing investments in infrastructure and basic service delivery, (2) the level of taxation (which alters how much governments and households spend on basic services, and also has indirect effects on profits and investments), (3) borrowing from commercial financial markets today while avoiding future creditworthiness problems, and (4) attracting FDI and private business growth while avoiding higher real wages in the public sector. MAMS underlines the importance of public spending effectiveness in determining optimum choices in the face of these trade-offs.

Because the targets in the SDGs are linked to each other and are quite comprehensive in scope, a comprehensive approach to spending and financing inputs is needed in addition to sector budget allocations. For example, recent research has suggested that sanitation is a critical factor in reducing malnutrition, so the goal for nutrition cannot be assessed just by looking at budget allocations for nutrition programmes.⁴ Similarly, girls' education is one of the most important investments in reducing child mortality. The cost of achieving the desired outcome in any one area, then, depends on whether other targets are also being met. A national plan, derived from a model like MAMS, can take these synergies into account in developing budget allocations and spending targets for the government.

Why country context matters: examples of trade-offs across objectives, sources and time

One difficult issue in costing is assessing how needs and revenues change with general economic conditions. For example, the wage bill for nurses, teachers and other public sector employees is not usually directly linked to productivity in their own sector but to growth in tax revenues and conditions in the wider labour market. These depend on private sector activity. If massive FDI is attracted into a country it can lead to an appreciated exchange rate and hence higher public sector wages in dollar terms (and so a higher dollar cost of providing health and education services), but it can also lead to larger tax revenues and more income for households who in turn will spend more on health and education. The net impact of these forces is uncertain and will vary by country. But generally speaking, successful economic growth will raise the need for infrastructure investments and for spending on public services, unless it is accompanied by an improvement in the efficiency with which public funds are spent.

The composition of budget allocations also matters for growth and welfare. Carnahan and Evans (forthcoming) argue that in fragile states, emphasis should first be given to spending that promotes stability, including police, law and justice sector support as well as selected social spending, and jobs and livelihood programs. Productive investments in infrastructure to accelerate economic growth should only come later. In other situations, however, the sequencing could be reversed. An emphasis on productive investments can jump-start or sustain growth, which in turn can generate tax revenues for expanding social spending at a later date. These examples highlight the need to understand country context when determining spending priorities and sequencing, in order to arrive at a national financing plan.

MAMS can be used to frame priorities for a specific country. An example is given in Box 2.

No country exists in an international financial vacuum, of course, but what are the consistency problems that arise in tapping international sources, especially on market-related terms?

Looking up from country level: the missing middle problem

National financing plans have to be made consistent with access to concessional foreign assistance and other sources of domestic and international capital. Most countries would prioritise access to grant-heavy aid over other forms of finance because such assistance has the fewest economic trade-offs (although there may be political economy considerations if aid comes with conditionality and cumbersome administrative procedures). But many countries would also benefit from greater access to official lending on harder terms.

Box 2. MDG options in the country context – the case of Uganda

The case of Uganda is an example of how MAMS can be used to frame priorities in the context of a specific country. A main finding of the case study is that public social service delivery was not the best policy instrument to accelerate achievement of MDGs for health and education in Uganda. Instead, household income growth was a more important driver of progress in these areas, as was public investment in physical infrastructure like rural roads, which in turn led to higher household incomes and more household spending on health and education (Matovu et al., 2011).

The Uganda example will not necessarily hold in other countries, as results depend on key parameters and initial conditions in the country. If a country is close to eradicating extreme poverty, it will have to traverse the ‘last mile’ and target remote and excluded households. In the past, the unit costs of service delivery to hard-to-reach communities could be significantly higher than average unit costs, but advances in technology, particularly digital identification cards, have sharply lowered the cost of government-to-people transactions. Publicly funded safety nets will be an important new tool in implementing the SDGs, and if these new technologies are available they could alter the results from MAMS.

Benefits can be further amplified if aid, and harder-terms financing from multilateral and bilateral official agencies, can also be used to catalyse additional private capital. Given the history of debt crises in countries, and the substantial economic costs associated with them, it is important to be careful about the extent of indebtedness. However, these risks can also be overestimated. Current tools for assessing creditworthiness like the Debt Sustainability Framework of the World Bank and the IMF are backward-looking and based on historical conditions in global capital markets. They have not been updated to take into account the new low interest rate/high returns to infrastructure investment context for development. There is an ongoing effort to make this tool more flexible, but it remains limited in its ability to integrate the composition of public spending into a macroeconomic analysis. Instead, all public spending, recurrent and capital, is treated the same.

As a result of these and other restrictions, some of which are redundant, many LMICs are unable to access the non-concessional lending arms of IFIs to a sufficient degree, and are driven to private capital markets as a preferred alternative, despite the higher financial costs involved. Market-related official lending is not providing the bridge between aid and private capital markets that it once did. In 2013, only \$11 billion in net disbursements from official lending on such terms was recorded. Guarantees cover only \$5 billion per year on average.⁵ Without much more financing from official institutions, it is unlikely that sufficient funds will be available to meet the SDGs (see further analysis and recommendations in Section 5).

Can supranational coalitions to raise money for thematic purposes, i.e. global partnerships, come to the rescue?

Global thematic partnerships, their strengths and weaknesses

Of the three categories of SDG needs described by ICESDF (as noted in Section 1), global sectoral (or thematic) partnerships and campaigns are best suited for the first type: mobilising resources for basic needs including food security, health, education, access to affordable energy and water and sanitation. Partnerships that bring together aid providers, partner countries and private philanthropies and foundations have shown how multi-stakeholder solutions can be devised. By focusing on outcomes, they have brought a results orientation to financing. They have provided a platform for communities of experts to analyse evidence, share knowledge and communicate with the rest of the world. Through global partnerships focused on basic needs, it seems possible to motivate individuals, businesses and governments by showing them that their contributions and efforts are making a tangible difference to the lives of the poorest.

Although these sector partnerships have tried to include private business (for example, the private sector window in the Global Agriculture and Food Security Program), the results to date have been limited, outside of health. Nevertheless, a growing number of corporations have started sustainability reporting as part of their standard management toolkit and have found ways of aligning their core interests in long-term profit maximisation with a sustainable development approach.

Global partnerships for national sustainable development investments (such as renewable energy) have not been widely used. Many of the investments are large, and financing is raised on a case-by-case basis as in mega-infrastructure deals. There is a desire in some advanced countries to treat emerging economies in a differential fashion if they are viewed as significant economic competitors (see Section 5), so a global approach is not always preferred.

Global partnerships could in theory also serve to rally support for global public goods that are currently heavily underfunded, but in practice they have not worked well. The UN's peacekeeping operations face severe budget shortfalls. Biodiversity funding has never received the attention it merits, despite its inclusion in the MDGs. And although the climate change mitigation challenge has been approached with a promise of truly 'additional' financing and with the creation of the Green Climate Fund, the Fund has only just begun to receive major pledges of assistance (\$2.3 billion as of 30 September 2014). The most recent example, tackling the Ebola challenge, shows just how hard it is to fund preventative investments that characterise many public goods, like health system strengthening, rather than treating crises *ex post*.

It must be noted that, historically, funding for public goods has been difficult to mobilise. This is true at the national level, where most countries still have inadequate protections to ensure clean air and water, for example, and it is doubly true at the global level. There are no instruments for a common global tax, which would be the preferred economic way of financing global public goods from a purely technical perspective, so voluntary contributions are solicited from individual countries. But getting agreement on adequate funding levels is hard. Countries try to shift the burden onto others (the 'free-rider problem'); the UN has adopted language called 'common but differentiated responsibilities' to indicate an understanding that burden-sharing will differ depending on the issue and on country circumstances and context, but there are no global rules or standards for financing public goods like peacekeeping, climate change or biodiversity. As a result, these critical areas of sustainable development are still massively underfunded across the globe.

Thus, global partnerships are most likely to be useful for the category of basic needs financing where the link between resources and results is more visible. For national sustainable development investments, country-level or project-level partnerships to unblock policy constraints and share risks are likely to be more efficient. For global public goods suffering from the free-rider problem, incentives other than coercive treaties or taxes may be needed. For example, awareness campaigns to educate people about the need for change can prompt collective action even without financial incentives. An example is climate change: the movement is reaching a critical tipping point, with masses now prepared to contribute because it is the 'right' thing to do, as well as the 'smart' and 'necessary' thing to do. Global solidarity of this type can potentially offset the free-rider problems that presently exist (Jameson and Miyoshi, 1998).

If the private sector is relatively less easily reached by global partnerships, except in a few specific cases, how then is its potential to be best tapped? And where is it most likely to be effective and under what conditions?

Policies for unlocking private financing for sustainable development

The Monterrey conference of March 2002 presented a major breakthrough in terms of expanding ODA to provide the resources necessary for achieving the MDGs – in exchange for which, developing countries would give priority attention to the specific targets agreed in the MDGs. At the next financing for development conference, scheduled for July 2015 in Ethiopia, the bargaining will be more subtle. There are only around 30 LICs that can expect to continue to receive ODA for the entire 2015–2030 period, while there are about 30 major assistance providers, including emerging powers, plus 130 countries that are not really in either category – though more and more of them are becoming simultaneously 'receivers' and 'transmitters' of development cooperation (ideas, know-how and trade links as much as finance) from each other. Engaging these 130 countries which are primarily interested in national sustainable development investments, and improving their access to finance is one principal challenge for the conference. Avoiding a divisive zero-sum discussion of where to draw aid, or international public finance, allocation boundaries is another.

This suggests that the discussion on financing for development must shift in large part from a quantitative 'needs' assessment to a qualitative 'policy' discussion. It will not be possible to pledge, for example, that private resources will flow to developing countries, but it will be possible to undertake a series of policy commitments – including global systemic changes like collaboration to stem illicit financial flows – that should help to unlock more long-term capital for sustainable development.

In order to do this successfully, policy issues must be disaggregated sufficiently in terms of their impact on goals and targets so that the link between outcomes, policy change, and the provision of additional financing by these independent actors is made clear. Generally benign policy prescriptions, like 'improve domestic financial markets and open capital markets', can help create the right environment for private capital flows, but there are different issues in each sector that warrant more specific attention.

Table 2 below shows five areas where there are policy and institutional blockages to the flow of long-term private capital into five core sustainable development sectors: (1) infrastructure and decarbonisation of the economy, (2) agriculture and food security, (3) extractive industries, (4) social impact sectors, and (5) services, especially finance (Kharas and McArthur, 2014). In many conventional descriptions to date, item (4) is scarcely alluded to, but private provision of health and education services, solar lighting and energy-efficient cook stoves and other social investments has soared. Social impact investing could be a \$500 billion asset class by 2020 (Freireich and Fulton, 2009).

Table 2. Gaps and priorities for enhanced private investment

Investment category	Common missing pieces		Institutional implications for global actors
	Regulatory, procedural, or policy	Public investment or fiscal support	
Infrastructure and decarbonisation	Project preparation; regulatory agency strengthening; domestic financial intermediaries; long-term political risk insurance	Commitments to carbon pricing; more willingness to use guarantees and first-loss instruments; public finance for enhanced credit mechanisms	Larger multilateral mechanisms that support project preparation and provide public non-concessional loans; adequately funded climate funds to subsidise clean energy; harmonised procedures among development finance institutions
Agriculture	Comprehensive national agricultural plans; subsidy and procurement price reform; land and water regulations; organisation of farmer associations to more easily link into global value chains	Investment in roads, ports and storage; credit systems; climate and crop insurance systems	Agricultural research in developing countries; large-scale support for agricultural credit; country-level public-private partnerships; national agricultural transformation agencies
Extractive industries	Community consent; transparency requirements for exploration and negotiation	Sustainability of local social service provision; local development benefits	Establishment of national sovereign wealth funds and/or prudent budget policies for managing natural resources wealth
Social impact sectors	Permit for-profit social enterprises; standardised social and environmental results monitoring	Early stage capital; social impact bonds where appropriate	International mechanisms/portals to scale up social enterprises; consistent standards to judge impact
Services (e.g. finance, retail, information technology)	Macro-prudential regulations; financial market development; transparency of subsidiary investments	National development banks; equity provision for small and medium enterprises	Stronger regional credit rating systems

Source: Kharas, H. and McArthur, J. (2014).

We discuss each sector in turn below Table 2, which summarises the issue. This is not to minimise the importance of general improvements in standards, rules and global partnerships, but to recognise that additionally there are important sectors that require specific treatment if significant change is to occur.

There is considerable private sector interest in financing infrastructure, but the private sector currently provides only one-third of all infrastructure finance and is unlikely to move beyond 40%-45% (Bhattacharya, 2012). The task force report of the Australian B20 (a business group set up to advise the G20 leaders' summit) identifies inadequate project selection and prioritisation (project pipeline), weak project execution capabilities, unstable investment and regulatory environments, and opaqueness and corruption as key barriers (B20, 2014). They call for the establishment of a global infrastructure hub (launched in Sydney by the G20 in November), procurement reforms and harmonisation, international accounting changes to reduce the bias against long-term infrastructure investments, and improved credit enhancement and co-investment mechanisms that reduce risks in the early stages of the project. This mix of policy, institutional and financial instrument obstacles suggests roles for aid, for capacity-building in the public sector, and for risk-bearing instruments among other official finance (OF).

Agriculture investments are heavily driven by the private sector and there is renewed interest in the integration of smallholder farmers into global value chains managed by large multinational companies. The New Vision for Agriculture platform of the World Economic Forum has developed a transformation framework that calls for strategies and priorities to identify effective directions, and delivery at scale of hard and soft infrastructure investments, with associated financing and risk management solutions. These principles are being operationalised through national and regional partnerships. Within these, there is a significant role for aid in organising farmers to reduce the transaction costs of linking them into value chains (including of large commercial agriculture), undertaking the public good of training, investing in physical infrastructure like rural roads to improve connectivity, undertaking research and diffusing knowledge, and improving the strategic planning and executing capabilities of national ministries.

Extractive industry businesses are among the largest providers of FDI in LICs. To avoid the 'resource curse', projects in extractive sectors should be accompanied by associated programmes for local livelihood development, extensive consultations of affected groups, and public expenditure management strengthening. Infrastructure to help offset Dutch disease problems may also be important. Aid and public development finance agencies

can contribute. In addition, international and domestic regulatory bodies can promote standards with greater transparency and reporting by firms with country-level detail, as for example by implementing agreements such as the Extractive Industries Transparency Initiative.

Social impact investments are the placement of capital with the ‘intention to generate a measurable, beneficial social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below-market to above-market rates, depending upon the circumstances’ (Impact Investing, 2014). Those social impact investments that earn commercial rates of return can be scaled quickly when a successful business model is found. Impact investments can cover several social sectors, including health, schools (even primary schools for low-income communities), water supply, sanitation and other services. Usually, they are best suited to sectors where operating costs are low and can be managed within an affordable price point but where upfront investment costs (both physical and organisational) are high and cannot be recouped with the slim operating margins that are available (Kubzansky, 2013).

If grant funds were available to internalise the many social and environmental externalities generated by social impact investments, or to provide catalytic early stage capital, the scope for more rapid diffusion is enormous. Some studies suggest that investment opportunities in this market segment could be between \$400 billion and \$1 trillion in the next decade (O’Donohoe et al., 2010). Private philanthropic funds, which are more nimble than most aid, might be best suited to pursue these opportunities. But regulatory changes can also help. The G8 countries have each prepared a report on what can be done in their own countries. In the United States, the report concludes, ‘Policy matters greatly. Government acts as regulator and standard setter, but also as a co-investor, risk mitigator, major buyer of goods and services, and sometimes as a market maker’ (NAB, 2014). The report concludes that the industry is at an inflection point of growth. However, any public funding that is used should demonstrate that the catalytic impact of public funding of these types of projects is indeed creating sustainable development in a more cost-effective way than direct financing through aid. A new \$200 million Global Innovation Fund has been launched by United States Agency for International Development (USAID), the Department for International Development (DFID), Sweden, Australia and the Omidyar Network to build these markets. The Fund will promote pilots and help successful ventures to scale up.

The **domestic financial sector** remains the most important channel through which private funding flows into developing countries. Strengthening regulations, enhancing equity and risk-bearing instruments, and developing intermediaries with a focus on development activities can help ensure that long-term funds are made

available for sustainable development. Development finance institutions are well placed to help strengthen domestic financial intermediaries and the supporting regulatory environment.

The areas noted above cover many, but not all, sectors. Public goods – like police and justice sectors, but also including national statistical gathering, research and planning and execution capabilities – must be financed from government revenues or aid, even when delivery can be (partly) contracted to other actors. The extent of these ‘collective’ consumption expenditures by governments varies widely. They average \$550 (2011 PPP)/person/year in Africa and Asia, but are double that in Latin America, and average \$5,000/person/year in the United States (World Bank, 2014a).

In addition, the government should provide a range of basic services, sometimes in kind, but increasingly in cash. Safety nets for poor households, to provide food and other basic necessities to those affected by disasters, are becoming monetised as a way of improving efficiency.

The foregoing tends to assume that public and private flows for development are predictable and sustainable, broadly to the same extent in the same contexts. But that is not yet true, as we see now.

Volatility and complementarity of private and public sources

One key feature of sustainable development financing is that the money destined for it should be long-term and sustainable itself, at least at the country level and typically also at the sectoral level. This is often not the case. **Aid** received by countries can be highly volatile – naturally so in the case of humanitarian aid, but unnecessarily so in the case of development aid. ODA is more volatile than tax revenues in all country groups, for example (Table 3). The high degree of volatility gets reflected in projects that never expand to scale, and in an unwillingness of finance ministries to commit to expenditures before aid commitments are booked, and in shifting donor priorities and fads. Volatility of aid has been a particular issue in post-conflict countries where domestic institutions are weak and political upheavals are common, but where it is even more important to take a long-term perspective on development programmes (Fengler and Kharas, 2010). On average, volatility in aid has reduced its benefits to recipients by around 20% (Kharas, 2008).

Private finance is also volatile, especially in LICs, where both FDI and remittances display substantial ups and downs. Capital flow volatility has been linked to a significant dampening in economic growth (World Bank, 2002). It tends to be procyclical.

A focus on volatility in different contexts highlights that capital is not homogeneous but has to be considered in terms of its availability, push-and-pull factors in each sector, and interlinkages with other flows and with

Table 3. Capital flow volatility by source and country group (1995-2011)⁶

Country Group	ODA	Tax revenues	Domestic credit	Remittances	FDI
Low-Middle Income	0.24	0.04	0.17	0.21	0.46
Upper-Middle income	0.37	0.15	0.18	0.26	0.15
Low Income	0.17	0.07	0.21	0.40	0.43
Least Developed Country	0.16	0.22	0.24	0.16	0.29
Fragile states	0.27	0.14	0.24	0.44	0.47

Source: Data collected for European Report on Development 2014. Bold highlights substantial volatility (coefficient of variation above 0.2)

Note: Using coefficient of variation (standard deviation divided by mean).

different policy and institutional environments. It's also a reminder that policies matter in determining both the quantity and the quality of capital flows and their ultimate effectiveness in supporting sustainable development.

With this in mind, a menu of options for improving global financing frameworks for sustainable development can be considered. These options should, ideally, build on work that is already under way, accelerating the processes to arrive at consensus and broadening the partnership of those prepared to act now. This will enable the Financing for Development conference in Addis Ababa to focus on concrete outcomes. In addition, space must be left for new ideas and initiatives as markets are changing rapidly in many areas. The Addis event cannot be the last word on development finance for the SDGs. We offer some specific additional suggestions in Section 5.

We end this section with a small demonstration of how hard it is to pin down the private-public development finance interface and, by the same token, what could be achieved if we had better metrics and more transparency in this area

Towards a Market Aid Index: a first cut

When considering the interface between public and private finance, at any level, it soon becomes apparent that there are no widely agreed concepts and metrics that can benchmark the intent and/or effect of such combinations.

The bigger underlying problem is that there are no common standards to help judge whether or not a private investment has been triggered by some specific public support. Part of this in turn relates to rarely having a counterfactual by which to gauge the catalytic impact of the public support given, compared to a purely private alternative. Public agencies are also failing to account consistently for their inputs, i.e. which pieces of the international public finance pie are particularly associated with private finance and which are not. There are no common definitions, for example, on leverage; and

reporting is weak and inconsistent, notably on guarantees (see Section 6 for specific suggestions).

We thought it useful to test drive a crude 'Market Aid Index' that attempts to compare the extent to which donors deliberately associate their activities with private finance or market-oriented projects and programmes. As far as we know, this is the first time it has been attempted. We started with Development Assistance Committee (DAC) bilateral donors only.

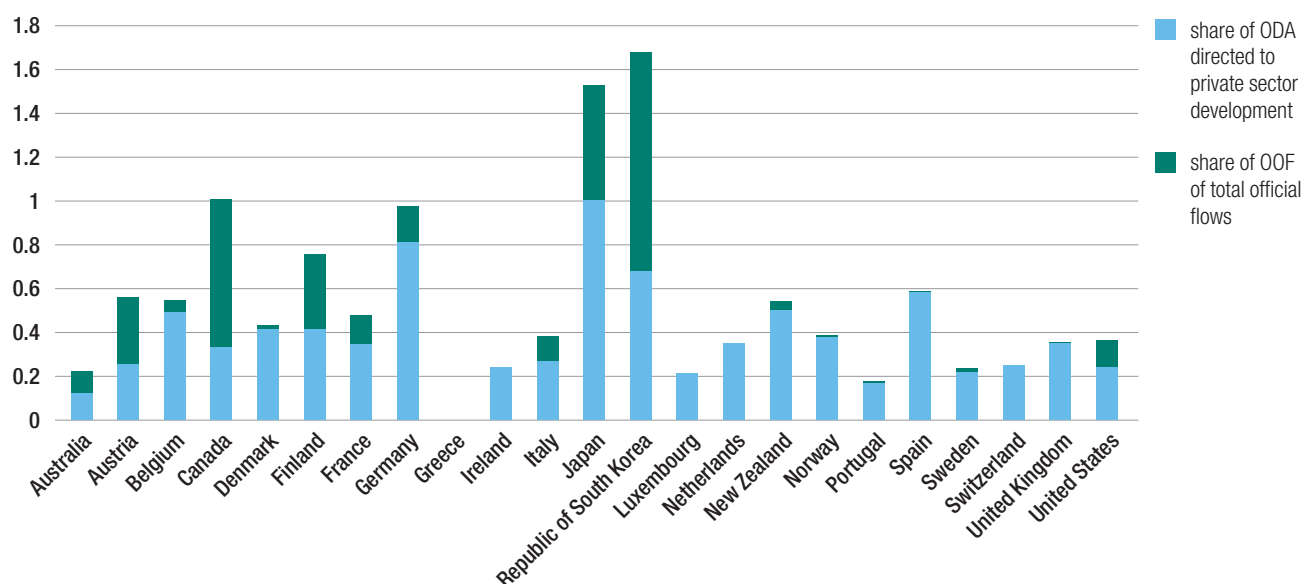
The methodology is sketched out below and expanded in Annex 2. We had intended to use a third element in this index, counting guarantees as well, but too few donors responded to the relevant DAC survey (and with very high variance) for this sample to be reliable. We think further work on these definitions could be extremely helpful, for both private and public finance actors. We also did not, for now, extend the analysis to the multilateral banks, or the imputed share of their activities to be credited to their shareholders, but this could be done.

Our Market Aid Index is based on analysis for a range of DAC countries of (1) the share of their ODA (not adjusted for the share of grants and loans within it) focused on private sector development and catalytic financing (see Annex 2 for details) and (2) the OOF share of their total official flows – ODA plus other official flows.⁷ For each of these categories, countries are given a normalised score 0 (for the lowest share in each category) 1 (for the highest share in each category), and the index combines their scores for both of these categories. The maximum possible score is therefore 2.

We stress that there is no normative significance – no implied merit rating – attached to achieving a higher or lower score in this index. It is just an attempt to quantify what share of the donor's activities is plausibly associated with private finance for development. Ideally, this input perspective should be combined with impact measures, which as mentioned are particularly hard to come by in this area.

The countries with the highest overall score by some margin for this index are Republic of South Korea (1.67)

Figure 2. Market Aid Index



Source: Authors' elaboration on the basis of OECD Creditor Reporting System.

and Japan (1.53), with Japan having the highest share of ODA focused on private sector development and catalytic financing and South Korea the highest share of total official flows provided through OOFs. Other high-scoring countries overall are Canada (1 – largely based on its OOF score of 0.68) and Germany (0.97 – largely based on its ODA score of 0.82). Those also scoring highly on their ODA levels include Spain (0.58), New Zealand (0.50), Belgium (0.49), Finland (0.41), France (0.35) and the UK (0.35). Those also scoring highly on their OOF levels include Finland (0.35) and Austria (0.31). (Note that the UK, unlike others listed, does not operate a bilateral development bank as such.) A number of countries, finally, scored below 0.3 on both categories of the index, including Greece (the lowest scorer overall and on private sector

shares, with no OOF reported), Portugal, Luxembourg, Australia, Sweden, Ireland, Switzerland, Italy and the USA.

A very preliminary interpretation of this scoring is simply that donors vary considerably in the range and intensity of instruments they deploy to draw on or connect with private market finance, and in the case of OOF versus ODA loans, in the terms they offer. This variation matters, especially in a favourable capital markets context. The bigger challenge remains not just in determining the size of public financial inputs aimed at catalysing private sector-led development, but also in establishing their impact.

We now turn to how different types of countries are affected by different flows of finance, and what implications this has for public policy.

Section 3: Development finance and country classifications

Summary:

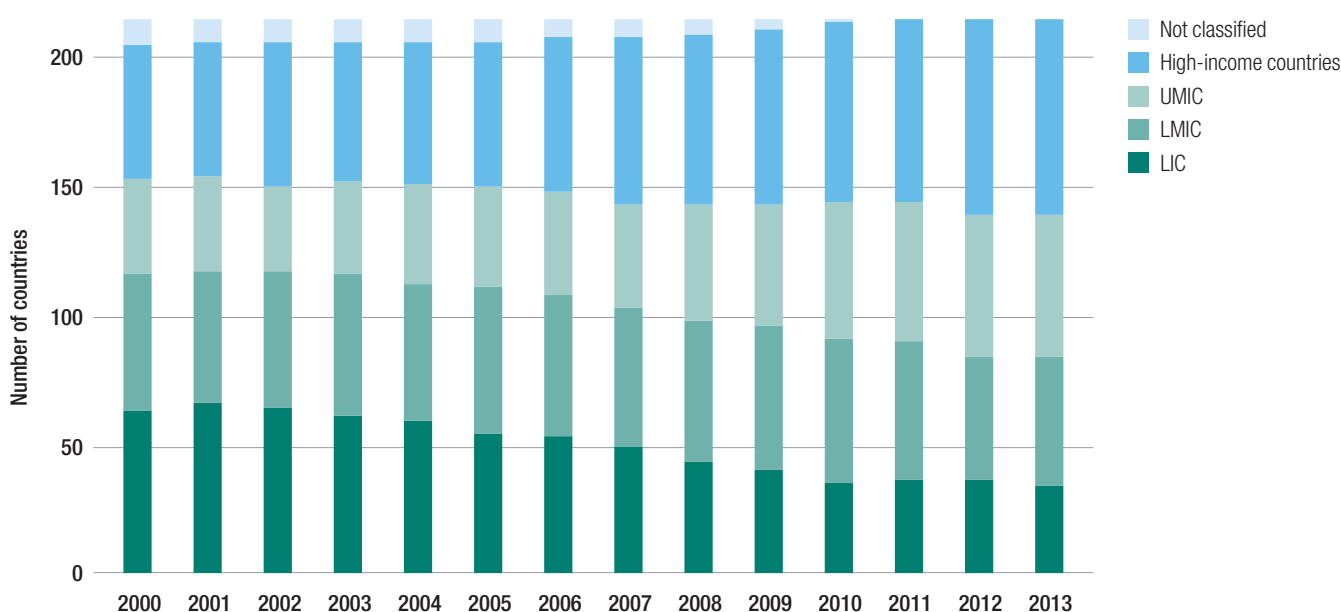
We look at how a country's mix of development finance changes as it grows. Static per capita income thresholds are increasingly unreliable guides to allocation, and categories based on them exhibit wider variations in key poverty-related attributes than do other internationally recognised categories, such as LDC. Considering financing patterns for each country as its income rises, a 'missing middle' emerges. Total public finance falls continuously as a share of national income, right up until the high-income threshold, as aid falls faster than tax revenues rise. Private external sources not only do not correct for this, they actually accentuate the proportional fall in foreign resources, especially as the share of remittances peaks at around the LMIC threshold. Alternative groupings would therefore also need to take into account factors like fiscal

capacity, as well as creditworthiness and vulnerability. Many LMICs, as well as most LICs, would need to levy prohibitively high marginal tax rates to close their poverty gaps unaided.

The problem with income-based classifications

Since 2000, 30 'low-income' countries have become 'middle-income' (see Figure 3)⁸, surpassing the middle income GNI per capita threshold of \$1,045 in 2013. Notice that this only corresponds to less than \$3 per day, on average, and of course many millions are below that average. There are now only 33⁹ LICs left in the world, compared with 63 in 2000.

Figure 3. Country classification by income level



Source: Authors' elaboration on the basis of OECD Creditor Reporting System.

There are two main problems with income-based classifications.¹⁰ The first one is analytical. The middle-income country (MIC) group is already very heterogeneous in terms of major poverty, human development and other attributes. It encompasses such diverse countries as Organisation for Economic Co-operation and Development (OECD) members Mexico and Turkey, at the top end of the spectrum, and Madagascar, Zambia and Nigeria at the bottom end, with among the highest shares of population in the world living below \$1.25 day in 2010.¹¹ The LIC group is also diverse, with some countries in conflict, others small islands, and still others struggling to cope with poor governance. Some are landlocked with little prospects for trade, while others have dynamic neighbourhoods. Many countries, both LICs and MICs, have poor data, resulting in large sudden changes in income per capita simply due to the serendipitous result of rebasing of GDP statistics,¹² as occurred recently in the cases of Ghana, Kenya and Nigeria.

The second problem with country classifications is operational. Being an LIC is the main criterion for eligibility for grants and concessional loans under the (so-called) soft-loan window of the World Bank Group, the International Development Association (IDA),¹³ and this status also informs the allocation policies of many other agencies. Countries that graduated from IDA to less concessional World Bank terms (IBRD) hitherto did so relatively abruptly, and this move typically triggered a deeper overall reduction in the volume of external finance. But it usually takes much longer for such graduates to achieve substantial and reliable financial market access, or to develop their own domestic tax base. Meanwhile, these less concessional public windows may not meet the graduate's needs in either volume and/or other terms (Section 5).

Next, we look more closely at the typical 'missing middle' funding problem.

The missing middle: international flows fall faster than tax revenues rise

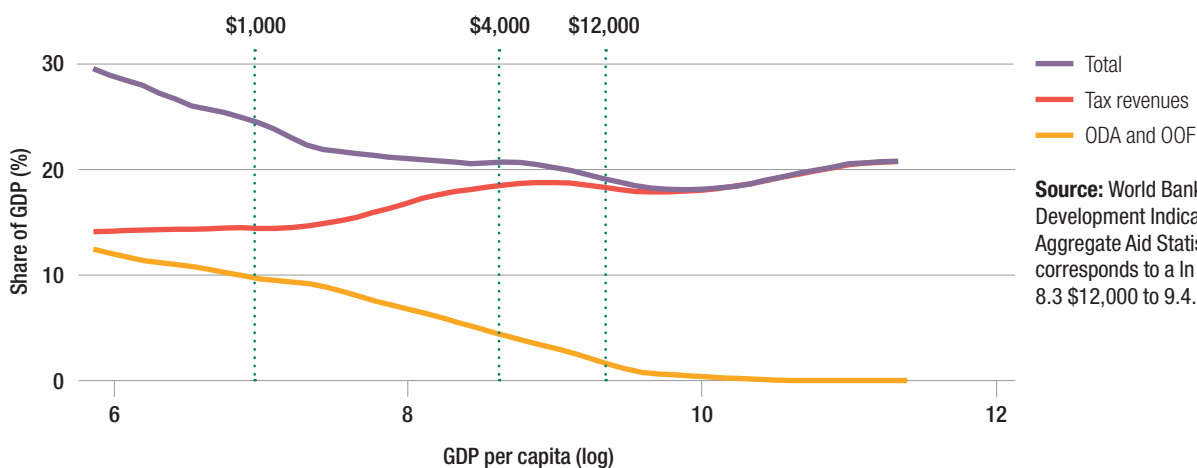
Clustering around arbitrary income thresholds may have very little bearing on the different access to and capacity to mobilise resources of each country, which are continuous rather than discrete (Kenny, 2011) along the income per capita spectrum. There is no statistically significant pattern distinguishing LICs from LMICs for tax revenues and FDI inflows. There is only one flow where LICs do strongly differ from the other two income categories and it is ODA, where LICs are the largest recipients of ODA as a share of GDP.

A different picture emerges if we track and smooth shifts in resources for a wide range of developing countries in 2011 and 2012 as their per capita income rises. (The methodology for this analysis is explained in Annex 1.) External public finance, both concessional and market-related, declines steadily and then more steeply as a share of GDP as country income progresses from a very low base (yellow in Figure 4 below). As we see in Figure 5 and Section 5, OOF – especially the market-related lending of MDBs – plays a negligible corrective role, for supply-side reasons. This decline continues until upper-income levels are reached. Meanwhile, domestic tax revenues do rise with income per capita, but only when countries are well into the middle-income range (red line in Figure 4), and this rise levels out as international public finance continues its fall.

The net result (purple, Figure 4) is that total public finance available falls, in proportion to national income, over a critical stage in country income growth. The fall in the share of ODA and harder-terms loans is not compensated by rising tax revenues for countries whose per capita income is between \$1,850 and \$13,000, i.e. until high-income status.¹⁴ Total public resources at best stabilise at the upper bound of LMIC before continuing to erode.

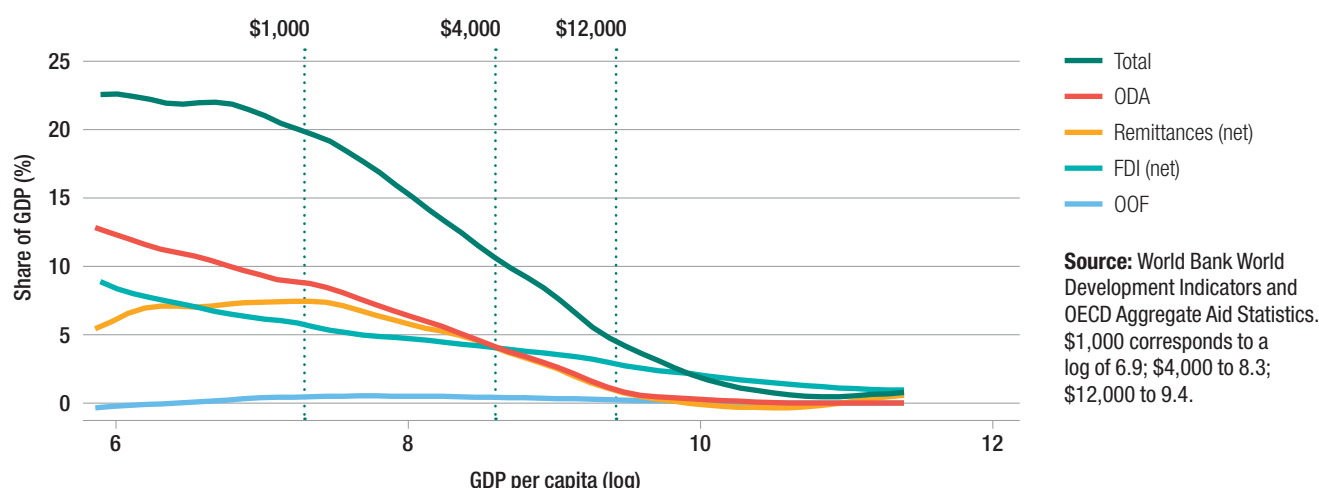
This declining international public support as country incomes and general government revenues grow (a 'missing

Figure 4. ODA, OOF, tax revenues as a share of GDP by per capita income



Source: World Bank World Development Indicators and OECD Aggregate Aid Statistics. \$1,000 corresponds to a ln of 6.9; \$4,000 to 8.3 \$12,000 to 9.4.

Figure 5. External flows as a share of GDP by per capita income



middle’) is, if anything, aggravated by a simultaneous retreat in private external finance (Figure 4). FDI, which is already proportionately important at quite low-income stages (Section 2), and remittances, which peak at around the lower MIC threshold, fail to compensate for the decline in international public resources. This necessarily leaves domestic private finance to pick up the slack as income rises – not a problem in itself but full of policy implications for the SDGs.

The first and obvious policy conclusion this takes us toward is to try to rectify the fall in international public finance by better differentiation of concessional assistance in favour of less creditworthy countries (see also section 1), as well as encouraging both more market-related funding overall and a smoother official process (section 2 above and 5 and 6 below) for “graduating” LICs.

A second line of enquiry relates to finding alternative country allocation criteria that take account of the slower build-up of domestic fiscal revenues across this transition. We first look at fragility, in addition to creditworthiness, as a possible but problematic benchmark.

Moving beyond classification based on income levels: fragility and domestic tax capacity

With as many as 130 developing countries that are likely neither to remain long-term aid recipients nor to become advanced donor countries (Section 2), some alternative clustering of needs and capacities along common features would still be helpful to inform policy decisions on allocating limited resources across countries. We discussed grouping countries by creditworthiness in Section 1. Are there other useful ways of representing logical groupings relevant to needs and availability of resources that are both analytically sound and politically feasible? We look mainly here at (1) *fragility*, including as

proxied by UN-recognised categories like LDCs and SIDS, and (2) *domestic tax capacity*, in relation to resources needed to close the country’s poverty gap.

Fragility

With the future locus of global poverty projected to be in fragile states (Kharas and Rogerson, 2012), one could consider distinguishing countries based on whether they are classified as fragile or not, but fragility is not a more consistent indicator, analytically, than income level and there is a lack of consensus over its definition. For example, the World Bank and the OECD classify different countries as ‘fragile’. In both definitions, fragile countries¹⁵ have on average much lower tax ratios¹⁶ and significantly higher aid ratios¹⁷ than non-fragile countries. But there are countries classified as fragile that can mobilise more domestic resources than non-fragile countries (such as Bosnia and Herzegovina and resource-rich countries like Liberia). Some fragile countries have had conflicts, others not. Fragile countries include aid darlings, such as Afghanistan and Malawi, but also aid orphans, such as Chad and Sierra Leone (Ericsson and Steensen, 2014), and countries with relatively low aid/GDP ratios, such as Sudan, Yemen, Iraq and Bosnia and Herzegovina, the last two of which are also MICs.

Looking at the other accepted ways of clustering developing countries – World Bank operational thresholds (IDA, Blend and IBRD); LDC; SIDS; landlocked developing countries (LLDC); categories of the Human Development Index (HDI), low, medium and high development – they all appear more homogenous than the income classification (pale green bars for LICs, LMICs and UMICs) (Figure 6)¹⁸ when looked at from the perspective of ODA ratios.

Why so? Some of these classifications build in a gradual process for graduation (LDC graduation requires at least three more years after at least two of the three criteria are met, for example), while others are invariant because they

ODA ratio (% GDP)

Category	Sub-category	ODA ratio (% GDP)
Income	LIC	0.90
	LMIC	1.35
	UMIC	2.90
World Bank operational thresholds	IDA	1.00
	Blend	1.00
	IBRD	1.35
LDC	LDC	0.95
	non-LDC	2.00
LLDC	LLDC	1.00
	non-LLDC	1.70
SIDS	SIDS	1.05
	non-SIDS	1.55
HDI	Low	0.95
	Medium	1.40
	High	1.70

are tied to the country's geography (SIDSs and LLDCs), and yet other measures are broader-based, going beyond income (LDC classification also takes into economic vulnerability, measured by exposure to shocks and shifts in exports and to natural disasters; HDI factors in life expectancy; mean and expected years of schooling, etc.).

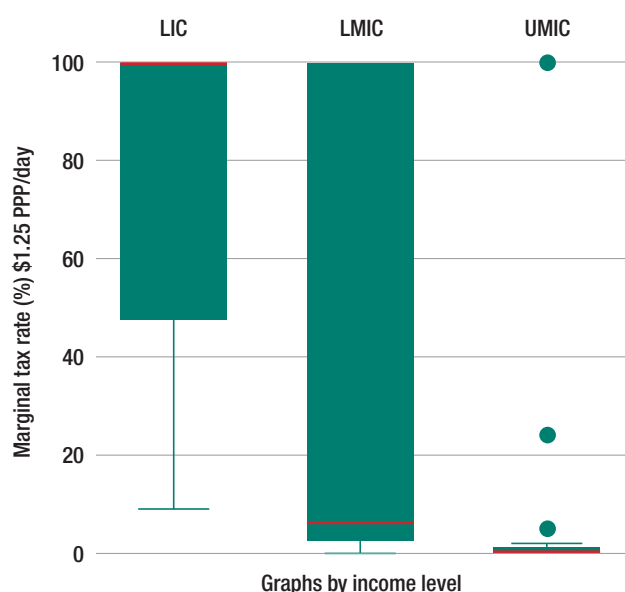
One of the objectives of development assistance is to allocate resources to those countries that do not have sufficient capacity to mobilise their own resources for poverty reduction. A good way to measure that capacity is to compare the poverty gap – the total level of public transfers potentially needed to pull all those below the \$1.25 a day (PPP) poverty line up to it – with tax revenues.

Considering a country's ability to redistribute its resources to its poor people, the LIC and LMIC categories become even less useful. Figure 7 depicts marginal tax rates along the income per capita spectrum (based on the

[illegible]

28 Financing the post-2015 Sustainable Development Goals

Figure 8. Marginal tax rate by income group



Source: Authors' elaboration based PovCal and World Bank World Development Indicators Poverty data released by World Bank in October 2014. Data reported in Annex 3. The whiskers-box plot describes the distribution in each income group. The median of the distribution corresponds to the red bar with the upper edge indicating the 75th percentile and the lower edge the 25th percentile. Dots refer to outliers. Based on income classification in 2012.

methodology set in Ravallion, 2009, but with poverty figures updated by the World Bank as of October 2014, see Annex 3.¹⁹ It is no surprise that the richer the country, the lower the marginal tax ratio. There are several LMICs, however, such as Cameroon, Ghana, India, Lesotho, Mauritania, Nigeria, Senegal, Swaziland and Zambia, that would require a 100% marginal tax rate on 'rich' taxpayer income to lift all citizens out of poverty (see top left of Figure 7).

Another way of looking at this variation is by comparing the marginal tax rate figures across income cluster. Figure 8 illustrates how dispersed marginal tax rates are – from zero up to 100% – in the case of countries classified as LMICs.

As Figure 7 and 8 show, if one accepts the idea that the marginal tax rate required to end poverty is a useful indicator of the gap between the extent of poverty and a country's ability to reduce poverty unaided, and if ODA should be primarily oriented to ending poverty, then it makes little sense for ODA to be allocated primarily according to recipient country per capita income levels.

Conclusion

With diverging performance among countries on poverty reduction and resource mobilisation, income classifications are becoming less and less relevant; LIC, LMIC (especially) and MIC groups are quite heterogeneous. Other recognised classifications – such as LDC and SIDS – are better options

for analytical purposes, including by capturing fragility attributes indirectly; both have relatively low variation in countries' performance on taxes and on ODA receipts. Two other criteria have to be factored into the classification of countries for development finance purposes: first, a proxy for financial market access and creditworthiness (discussed in Section 1), and second, a country's fiscal capacity to fill its poverty gap, as discussed in this section – which further argues for differentiation between LMICs.

These conclusions, however, relate primarily to the first two goal clusters in the ICESDF set (Figure 1), namely infrastructure and basic needs.

But what of the global public goods cluster and, in particular, climate change, which by definition invokes effects and priorities beyond the single-country context? Surely this requires a complete overhaul of the single-country development paradigm and how development programmes are designed and implemented today? We turn to this now.

Section 4: Climate change and development finance: strange bedfellows?

Summary:

We revisit the debate on trade-offs between ‘green’ growth paths and faster poverty reduction. Overall, the argument that poverty elimination needs to be slowed in the pursuit of global climate change mitigation does not hold. However, for a range of very poor countries with limited capital market access, self-interest may not align well with green growth. This need not be of international concern, as the aggregate share of the global carbon footprint of these countries will remain insignificant for many years. The geography of climate mitigation finance is however very different from that of development, and inherently skewed towards carbon-intensive emerging economies that enjoy ready access to global capital markets. The finite grant element available from concessional aid (until the latter is massively boosted by new resources tapped at the global level) will therefore have to be rationed in favour of adaptation (with a preference for LDCs) and in favour of less creditworthy countries for mitigation.

A trade-off between growth and climate change mitigation and resilience?

The current proposal of the UN Open Working Group on SDGs has separate and parallel goals for poverty reduction (*end poverty everywhere* or the ‘getting to zero’ agenda), sustainable development (*promote sustainable infrastructure and industrialisation and foster innovation and promote sustainable consumption and production patterns*, among other goals), and climate change (*take urgent action to combat climate change and its impacts*). At the same time, debates continue on a binding international climate action agreement to be reached at the 21st Conference of the Parties on Climate Change in Paris in December 2015²⁰ and on what comes next after the MDGs are running on parallel tracks.

There is a long-standing dilemma between reducing poverty and fighting climate change (and entering into a sustainable development path – Stern Commission and Fourth Assessment Report of the Intergovernmental Panel on Climate Change (IPCC), 2007) or, put another way, a problem of ensuring that countries grow fast enough to eliminate poverty in a generation yet simultaneously emit less or keep emissions low (Mitchell and Maxwell, 2010).

While, historically, economic growth was key for countries to reduce poverty at scale (with China being a notable example) and increase resilience/climate change adaptive capacity (as reviewed in Dercon, 2014a; Dell et al., 2008, 2009, Raddatz, 2009; Noy, 2009), growth based on fossil fuels has been damaging for the environment and for individuals’ health (see Dercon, 2014b), as it is

usually accompanied by increasing emissions and other environmental stresses (e.g. UNEP, 2007, as reviewed in Swart, 2008).

A structural shift from ‘brown’ to ‘green’ growth will not be cost free, because of the investment necessary to convert production process and technologies into low carbon and climate resilient capital stocks. The removal of fossil fuel subsidies would be beneficial for the poor only if the resulting savings in public finance were to be effectively recycled into other poverty reduction programs (see Dercon, 2014). Dercon (2014b) also draws attention to the acute problem facing some 50 countries who will be unable to fund their own fight against poverty (using a tax base with realistic marginal rates, see Section 3) without at least 15 years of rapid growth, implying a concomitant rise in emission intensity from a very low base. Yet even after 2030, these countries’ contribution to the global carbon footprint remains minuscule (2%-3%), which argues for differential treatment, with safeguards against ‘locking in’ high-carbon growth paths for the longer term. Dercon’s larger point is that green growth should be accompanied by sensible poverty reduction policies (facilitated by savings from cutting fossil fuel subsidies, for example), not that green growth should be avoided altogether.

There is a growing body of evidence that *poverty reduction through economic growth* and *sustainable, climate resilient development* are feasible concurrent policy objectives. The recently released report by the Global Commission on the Economy and Climate (Calderón et al., 2014) argues this to be the case when policy is examined in a dynamic context of change, and when existing economic inefficiencies and the multiple benefits of action and costs of inaction are taken into account. First, tackling climate change risk is seen as the only way to have strong and sustained long-term economic growth with a pivotal role played by innovative climate resilient production processes. Second, the costs of delaying action are estimated to be higher than the costs of acting now. Third, reducing the use of fossil fuel brings health benefits, and recycling revenues from carbon pricing increases fiscal efficiency, and both of these can offset economic costs of climate action (the latter estimated to be around 1.7% of baseline global GDP in 2030). Fourth, a ‘brown economy’ also comes with short-term direct costs: governments in both developed and developing countries directly subsidise production and consumption of fossil fuels by \$600 billion (see also Nakhooda, 2014; Whitley, 2013), which corresponds to 0.8% of global GDP, and indirectly provides another \$1,300 billion in subsidies (IMF, 2013, \$1.9 trillion in energy subsidies).²¹

In sum, there is ample reason to believe that climate resilient growth and rapid poverty reduction can – indeed must – go hand in hand, as a general proposition. However, when a subset of low-income, non-creditworthy countries consider their growth strategies, they may have to use higher discount rates than apply globally, leading to different investment choices appropriate for their specific context. This, however, should have a negligible impact on the global carbon footprint.

So, is there any other inherent tension between climate change finance and concessional development assistance? Well, yes, because their allocation principles are profoundly different and cannot easily be accommodated within a single set of rules.

Climate change and development finance: two silos?

What are the estimated costs of cutting greenhouse gas (GHG) emissions and improving resilience to the effects of climate change? Mitigation of GHG emissions in developing countries could, by 2030, cost between \$140 billion (World Bank WDR, 2010) and \$563 billion (McKinsey & Co., 2009) each year in upfront investments.²² For investment in climate change resilience (adaptation), costs are expected to rise to a yearly average of \$70 billion to \$100 billion, at 2005 prices, between 2010 and 2050 (see World Bank, 2010a; also Baudienville, 2010. Delete ‘and Climate Funds Update’). These latter figures amount to about ‘only’ 0.2% of the projected GDP of all developing countries in the current decade (World Bank, 2010b). While these cost projections are approximate, their upper range goes well beyond the levels of resources currently available to reduce emissions and to lessen vulnerability and enhance resilience. CPI (2013) estimates that total resources deployed to and in developing countries for climate change-related activities totalled \$182 billion in 2012, with a combination of North-South transfers (in the range \$39-62 billion) including both public and private resources – and the rest generated by developing countries themselves.

Taming the consequences of climate change and supporting development across the world are closely interlinked, yet the same cannot be said for their financing mechanisms and political drivers. Climate finance is often conceived as being shaped by the ‘polluter pays’ principle rather than by solidarity or ‘aid’, including policy-makers’ resistance to use traditional aid rules and principles (Mitchell and Maxwell, 2010) such as those embedded in the declarations on aid and development effectiveness (Ellis et al., 2013).

Furthermore, the development impact of climate change funding has not received as much scrutiny as development assistance, which is understandable as most climate change funds are relatively recent and it might be too early to assess them.²³ Finally, the Copenhagen Accord includes pledges of ‘new and additional’ climate finance of \$30 billion between 2010 and 2012 (known as ‘fast-start’ finance, FSF) and \$100

billion each year by 2020 (‘long-term’ finance), expected to be adaptation funding targeting LDCs, SIDS and Africa.

The bottom line in the United Nations Framework Convention on Climate Change (UNFCCC) arena is that new pledges on climate finance should not come at the expense of resources for development programmes already in place (‘additional’) and should not recycle existing pledges (‘new’). The Copenhagen Accord, however, failed to define ‘new and additional’, and this vacuum sparked a series of interpretations; a common tabular format for reporting a subset (the public component) of the \$100 billion has been agreed only recently (see Caruso and Ellis, 2013).

Commitments of \$30 billion between 2010 and 2012 by developed countries on FSF have been made (Nakhouda et al., 2013), considering funding from public sources only, with 61% going to mitigation and 18% to adaptation projects.²⁴

Nearly 80% of this \$30 billion has been classified as ODA flows (Nakhouda et al., 2013). The rest of the funding is classified as OOF, export credit, guarantees and insurance, mainly to finance mitigation projects; adaptation measures were supported primarily by grant financing. Eleven countries are among the top 20 recipients of both FSF and ODA (see Table 4), and there is positive correlation between ODA receipts and FSF allocations, but by no means full overlap – and the differences in country allocations between the two streams adds importance to the division of ODA between them. While India and Indonesia, for example, are still receiving substantial absolute amounts of ODA, their relative shares of FSF are much higher. If this FSF distribution became representative of a much larger pool of international public finance mandated for climate change mitigation in the future, clearly the overall country balance of IPF for ‘sustainable development’ would shift quite dramatically.

Many OECD countries have expressed the view that climate financing, especially adaptation, and development financing are closely linked at the project level and impossible to separate (see OECD 2013 submission to High Level Panel (HLP), World Bank 2010). Adaptation and resilience-building activities within countries may be particularly difficult to distinguish from activities that contribute to ‘good development’ (Jones et al., 2012; Fankhauser and Burton, 2011) and the strong overlap between ODA and FSF would call for moving beyond assessing ‘additionality’.²⁵

Therefore, aside from reminding us of the imperative of mobilising more resources internationally if and when we can, the ‘additionality’ debate is ultimately a red herring. It is inevitable that some substantial share of climate change resources flowing from developed to developing countries will be sourced from public funds and will thus overlap with official development funding, whether on softer or harder terms. Equally, it is inevitable that some share of resources from developed to developing countries will be sourced from private sources and so overlap with private investments in infrastructure and other components of green growth. Both sources of finance should be welcomed.

Table 4. Top 20 countries FSF and gross ODA 2010-2012

		Total FSD 2010-2012	Share of total FSF (%)		ODA commitments (const 2012 USD) 2010-2012	Share of total ODA commitments (%)
1	India	5,610	17.6	India	21,011	4.8
2	Indonesia	2,696	8.5	Afghanistan	20,861	4.8
3	Brazil	1,611	5.1	Vietnam	15,452	3.6
4	Vietnam	1,042	3.3	Pakistan	12,835	3.0
5	Kenya	918	2.9	Congo, Dem. Rep.	12,163	2.8
6	Peru	509	1.6	Kenya	11,701	2.7
7	Thailand	469	1.5	Ethiopia	11,253	2.6
8	Philippines	402	1.3	Bangladesh	11,058	2.6
9	Egypt, Arab Rep.	386	1.2	Turkey	9,404	2.2
10	Pakistan	378	1.2	Tanzania	8,309	1.9
11	Malawi	376	1.2	Haiti	7,871	1.8
12	Bangladesh	357	1.1	Morocco	7,488	1.7
13	South Africa	295	0.9	Indonesia	6,818	1.6
14	Tanzania	260	0.8	Jordan	6,810	1.6
15	China	244	0.8	Egypt	6,781	1.6
16	Uzbekistan	239	0.8	Nigeria	6,646	1.5
17	Afghanistan	237	0.7	West Bank & Gaza Strip	6,627	1.5
18	Mexico	233	0.7	Mozambique	6,065	1.4
19	Ethiopia	223	0.7	China	5,931	1.4
20	Honduras	202	0.6	Iraq	5,789	1.3

Source: Nakhlooda et al. (2013 and OECD 2014). Countries that are among both top 20 FSF and ODA recipient countries are indicated in bold.

For as long as public concessional assistance remains heavily rationed, we recommend the following:

First, to prioritise adaptation financing as far as possible from country aid budgets (with the latter taken as meaning CPA). As already internationally agreed, adaptation assistance should anyway target countries most vulnerable to damage from irreversible climate change, such as LDCs and SIDS.

Second, in creditworthy countries, where some investments consistent with a low-carbon emissions growth pattern are not yet commercially viable but mitigation is clearly in the national as well as global public interest, the answer is to make such investments possible with carefully targeted public support, mostly in the form of guarantees or publicly backed loans on market-related terms. This route is particularly relevant when interest rates are low and are expected to stay that way (see Section 1). Exceptions to this rule should be made only for LDCs and SIDS and other least creditworthy countries, which mostly do not yet offer major opportunities for emissions reductions but may need support to pilot new approaches.

Compared with current practice, this will mean channelling a much larger share of grant-based adaptation aid to LDCs and SIDS (just 38% of FSF for adaptation was disbursed to LDCs and SIDSs, based on Nakhlooda et al., 2013), as is the case for other forms of ODA. Establishing an explicit target for the share of adaptation finance going to these country groups could create positive incentives, and at the same time make it more likely that existing UN sub-targets for ODA to LDCs are met, given the high degree of intrinsic purpose overlap between adaptation and development.

This approach presumes, however, that there are sufficient non-concessional (or less-concessional) resources available for mitigation in MICs, and for this the world will be looking in particular to expanding the role, and capital base, of MDBs.

This assumption presents its own set of policy problems, to which we now turn.

Section 5: Institutional bottlenecks to be addressed internationally: reverse the erosion of non-concessional MDB lending

Summary:

We consider here the role of the MDBs, and in particular their ‘harder’ or market-terms windows. Net lending has been flat or negative for decades. It is not yet clear whether this stagnation is primarily the result of supply-side capital constraints, or if it also results from a lack of effective demand from borrowers, perhaps exacerbated by the institutions’ cumbersome processes and/or onerous non-financial conditions. However, there is substantial indirect evidence – considering country borrowing preferences, the creation of new institutions in competition with them, and the sustained surge in international infrastructure investments – that there is still plenty of need for the jobs they were created to do. An independent review should seek to establish this balance and recommend corrective action. Funding for the MDBs anyway needs to be looked at in the round, not in outdated silos for different ‘windows’, especially in a favourable global interest rate environment, and it needs to be extricated from self-defeating polemics.

We have shown in Section 3 how countries ‘graduating’ into LMIC status face sharply reduced concessional assistance but can expect only gradually increasing tax revenues and not enough market-based finance at the right time – hence the ‘missing middle’ of development finance available to them at this specific pinch point.

In theory, that is precisely why the so-called ‘market terms’ windows of the MDBs exist: to help these countries bridge their transition towards greater and ultimately full market access as growth prospects and institutional strength improve. As a matter of practice, however, official non-concessional flows (bilateral and multilateral) to developing countries no longer play this role to a significant degree. Total net disbursements reached a sizeable \$56 billion in 1983 but then steadily declined to become negative in 1995, whilst the number of countries reaching middle-income status grew steadily. Disbursements rose significantly for three years after the Asian debt crisis, before again returning to large negative flows. The same pattern has repeated since 2000: large negative net official flows, except for exceptional responses in 2009 and 2010 to the Great Recession. Most recent data for 2013 show net official flows of negative \$45 billion.²⁶

Why exactly this erosion has occurred is not completely clear. There is some evidence at country level (Greenhill et al., 2013; OECD, forthcoming) that countries eligible for these windows, and even softer loans,²⁷ are opting instead, at the margin, for significantly higher-interest international borrowing, notably from bilateral export credit agencies and sovereign bond markets. This situation may result partly from borrowers being deterred by the significantly higher non-financial costs of MDB loans and credits (such as allegedly intrusive political conditions, cumbersome safeguards and slow or unreliable processes). Borrowers may also feel they get more valuable reputational (signalling) benefits from tapping financial markets periodically in their own name than they do from going the indirect MDB route.

At the same time, there may be a variety of restrictions in the maximum envelopes, or earmarks within them, actually available from MDBs at country level. These restrictions might result from the institutions’ formal fiduciary policies and their methods of country risk and debt sustainability assessment, as well as less formal patterns of staff capacities, internal culture, and management preferences and political accessibility at various levels. Some of this information is neither in the public domain nor necessarily known to borrowing governments, who therefore would be acting rationally in heavily discounting estimates of how much they can actually draw down.

Some combination of these factors is intuitively plausible, but because the country and global demand for these institutions’ loans has never been independently assessed and then compared with their capital base, fiduciary rules and other institutional features, nobody (not even their boards) can presumably reach an objective, evidence-based conclusion on where this balance between demand-side and supply-side factors lies. The World Bank’s president has, however, recently stated (World Bank press release, April 2014) that IBRD can deliver another \$10 billion a year in loans without recourse to additional paid-in capital, mainly by changing fiduciary limits, maturities and other terms. This implies that there is no binding demand-side constraint.

This secular decline problem is aggravated by the peculiar set of threshold effects or ‘hard stops’ created at the boundaries of concessional (IDA) and non-concessional (IBRD) loan eligibility and their regional equivalents (Asia Development Fund/Asian Development Bank, etc.).

Behind the scenes, the uncomfortable truth is that more effort has been given to raising grants than to leveraging grant funds into larger volumes, albeit at higher financial cost. For example, IDA has raised \$225 billion from its shareholders since its inception, whereas IBRD has obtained less than \$17 billion²⁸ in paid-in capital from shareholders over the same period (Morris, 2014). And shareholder pressures are for even more transfers of funds from IBRD and the International Finance Corporation (IFC) to IDA. The same is true for other multilateral and bilateral institutions.

However, with plentiful liquidity in global capital markets, now could be the best time for years to reconsider the advantages of leveraging grants with private capital through development banks versus transferring them directly to developing countries (Kharas, 2014 blog reference). The number of MICs wanting to access cheap, flexible capital for development investments is growing, and capital market conditions for increasing supply are favourable. Several development banks are preparing options to do this, of which the most advanced is the ADB’s recent decision in principle to leverage the receivables in its soft window to improve its overall equity base. This technique, or variants of it, holds promise and deserves consideration by other institutions and the international community. However, each MDB is currently making progress independently, outside of any systemic or aggregate perspective for the global financial architecture.

Why then is additional capital for MDBs apparently so hard to raise? This relates partly to the damaging political perception – especially, but not only in the United States – that these institutions fund countries like China, India and Brazil, who are the OECD’s direct global competitors, and partly to the perception that MDBs are not aggressive enough in enforcing ‘developed country’ social and environmental standards.

In response, developing countries are creating their own purpose-built bilateral, regional-bilateral and multilateral institutions to provide market-based public lending. Several have long and successful track records, like the Andean Development Cooperation (CAF) and the Central American Development Bank, and others are more recent, like the Eurasian Development Bank. The newest of these is the BRICS’ New Development Bank (\$50 billion initial capital, pledged but not yet mobilised), and others are under discussion or have just been formally launched

(an Asian Infrastructure Investment Bank, a South Asia Development Bank). These agencies offer borrowing countries alternative funding choices, and potentially higher aggregate volumes of funding on keen terms, both of which are good things, but are unlikely to be of sufficient magnitude to address the funding shortfalls in developing countries. (UNCTAD, 2013)

These key facts – that (1) there are huge investments under consideration and feasible plans to deliver them; (2) several new institutions are being capitalised to service them, at considerable political, financial and organisational effort; and (3) developing countries are clearly willing to pay a large premium to access additional funding – add up to a strong and urgent rationale to try to unlock the MDBs’ own capital and unleash their performance.

We turn now to a specific set of reform recommendations, first for MDBs as a subsystem, and then more broadly.

Section 6: Specific recommendations for change

This section draws on the preceding ones to identify a few key arrangements and metrics that might be agreed within, or immediately following, international meetings such as the 2015 Conference on Financing for Development in Addis Ababa, intended to significantly improve the reach, complementarity and/or effectiveness of resource mobilisation efforts for the new SDGs.

They are filtered so as to offer the prospect of the lowest possible transactional and political costs in respect of potential benefits, yet not to duplicate existing proposals placed before international bodies.

We organise our own recommendations by objective, into **four categories**.

1. Boost market-terms lending by MDBs (rationale as in Section 5)

- Carry out an independent review of the likely future demand for non-concessional external finance and the strategic role of MDBs within this, especially in LMICs, with a view to eliminating the ‘missing middle’ funding gap.
- Consider mechanisms to leverage the receivables in the ‘soft’ windows of the MDBs to accelerate resource transfers in the near and medium term.
- Review and smooth – make more predictable and transparent – the process of graduating from IDA-type terms to ‘blend’ and then IBRD-type terms.
- Address MDB non-financial competitive weaknesses in delivery (speed, flexibility, communications gaps, etc.).

Comment: We hesitate to assign specific international responsibilities for carrying out these actions. Clearly ‘independent’ should mean as a minimum separate from the direct interests of the management and boards of the MDBs themselves. However, the process has to be seen as legitimate by all major stakeholders, as well as technically competent. For example, it will need to factor in the likely systemic changes brought to bear by recently created regional and/or bilateral-based development banks. Hence there is the obvious option of oversight by the G20, whose membership closely maps that of all these institutions’ main owners, but perhaps assisted by the UN to canvass borrower opinion beyond the G20 membership. The other three actions, once properly framed by the first, are within the scope of responsibility of the MDBs themselves, with periodic reporting back to the G20 and UN.

2. Boost access to market-related public finance more generally

2A. Agree on a new international indicator for ‘official finance’ (OF)

Comment: This would be without prejudice to, and in addition to, existing ODA commitments (0.7% of GNI, LDC sub-target 0.15 - 0.2% of GNI).

The idea is to report as ‘OF’ the face value of all official market-related loans that are not already counted as ODA (see Glossary). This is a similar approach to that currently taken for other official flows (OOF) as reported by DAC countries and some non-DAC countries. The main disincentives to reporting more loans on the OOF basis, and increasing their volume, are, for DAC members in particular, that there is no target for OOF as there is for ODA. Conversely, for many non-DAC countries, as they reject the ODA categorisation (along with the obsolete North-South lexicon of ‘aid’, ‘donor’ and ‘recipient’) as applying to them at all, by implication OOF, identified implicitly as that which is surplus to ODA, has limited appeal also.

The new metric should be as simple and liberally defined as possible, to encourage all providers to self-report, take credit for and ultimately increase their relevant activities, sidestepping unhelpful terms like ‘aid’ and ‘concessional’. It should not discriminate loans by their stated purpose (e.g. ‘development’ versus ‘investment promotion’). It should recognise as a separate subcategory the disbursements by multilateral and regional development bank loans. Reporting should be built up from data already submitted by member countries to the IMF and World Bank (who already compile global data on such loans, but are restricted in what they can report) as well as the DAC Secretariat.

The only possible restriction would be that the terms offered are plausibly more favourable than market offerings. The latter ceiling might be set as the borrowing country’s latest sovereign bond coupon, or even just a flat rate, say 10%. In practice it is highly unlikely that official lenders would charge rates at or above those offered commercially for the same risk (or that borrowers would be willing to pay them when the alternative exists).

2B. Set a new UN-agreed international target for OF

After a pilot phase in which voluntary self-reporting of OF is tested, it should be associated with a new UN-agreed international target (say, 1% of developing countries’

GDP or \$230 billion in 2012). Such a target, based on needs for sustainable infrastructure in particular, is more aspirational and relevant than one potentially based on contribution shares on the part of advanced and emerging market economies. Note, however, that just 0.5% of G7 GDP would today already amount to about \$170 billion. By some recent measures, the combined economies of the BRICs, plus Mexico, Indonesia and Turkey, are already of comparable if not larger size, making the 1% target eminently achievable.

Comment: The precise split between ODA and OF is of no pressing concern from a user country perspective, especially given current favourable terms on market-related financing. What “missing middle” countries, in particular, need now is much greater access to funding on market-related terms, from all quarters, including non-DAC countries. That is the main purpose of setting an international OF target.

This perspective is distinct from the more complex deliberations within the DAC of how to ‘modernise’ ODA as a measure of donor effort. DAC is reportedly close to reaching agreement on a new standard for loans scoring as ODA. The leading option is based on counting as ODA the entire grant element of official loans for development purposes, using a differentiated set of discount rates, depending on lender market conditions and/or borrowing country risk categories.²⁹

A parallel DAC proposal (see Glossary) is that once the grant element is fully counted as ODA, the remainder of the loan counts towards a new aggregate. This measure, tentatively styled total official support for development (TOSD), would also include other items, such as some security spending beyond that allowed under ODA.

Note that no targets for TOSD are planned, as yet. The old OOF aggregate also disappears under this arrangement, making it all the more useful to have a new UN-based OF definition.

3. Incentivise private finance and align it with development objectives

3A. Agree on basic definitions and metrics for private finance for development (PFFD)

Comment: The absence of clarity on this point encourages confusing, sometimes excessive and unaccountable claims. It distracts from the two key objectives of relaxing country credit constraints by encouraging more private finance and creating conditions so that investments bring about both profits and sustainable development.

A competent and legitimately convened working group should lead this work, preferably including UN, international financial institutions and other bodies, such as the DAC, as well as representatives from the private and impact philanthropy sectors.

As a minimum, we should agree that when international public finance gives comfort to international private investors or commercial lenders, in a public-private partnership for example, the face value of the private investment that public stake supports (in any fashion) should be counted as a distinct part of PFFD, whereas the public instrument involved should be part of ODA or OF, depending on its terms (see 3B below for treatment of guarantees).

PFFD should also preferably include disbursements of private voluntary commitments made under global partnerships established to support the SDGs, private investments consistent with national development plans (and reported as such by host countries), and social impact investments. It should ideally include all international private financing undertaken by national and sub-national governments or their agencies to finance budget deficits or other development spending categories as defined by ICESDF. It should also include international private philanthropy.

In the case of partnerships where more than one public agency is involved, they will need to apportion their claims to be catalysing the relevant part of PFFD accordingly.

Preferably this work should also set some standards to help gauge threshold levels of associated public stakes (minor equity holdings, technical assistance grants in kind) without which a largely private project would not otherwise have materialised, in the likely absence of a counterfactual where an investment is planned without such a stake.

As this work proceeds, it should also consider the pros and cons of establishing some form of ‘PFFD leverage targets’ to be set by those agencies that work with the private sector, as a share of their non-concessional flows or OF, to encourage them to use more risk-bearing instruments (see also our Market Aid Index, Section 2). The leverage target should not include any flows mobilised from other public agencies. Care of course needs to be taken to avoid encouraging perverse behaviour, such as attaching the smallest possible public sums to the largest possible private projects, which at the margin becomes totally ineffectual.

3B. Give explicit credit (including in ODA and/or OF) for undisbursed guarantees and other contingent commitments

Comment: It is an irony that, as things stand, guarantees are scored as ODA only when called and disbursed – which usually means that the relevant investment has failed – but not in relatively successful cases, when the guarantee is arguably having its intended confidence-building effect. There are accounting issues here, but most national accounting offices (such as the Government Accountability Office (GAO) in the USA) already have tools to assess the implicit budgetary cost of a guarantee. This cost should ideally be included as ODA, unless the lender pays for it,

in which case it would be OF.³⁰ All private investments in projects that are supported by even a small amount of a guarantee from a public development agency should be counted as PFFD, as the project will be, by definition, contributing to sustainable development (otherwise there is no case for the public intervention).

A possible extension of this approach would be to score some portion of all contingent commitments (such as the Advanced Market Commitment for pneumococcal vaccines administered by the GAVI Alliance), which are a set of ‘prizes’ or rewards for future action, payable on specific results triggers, even if the prize is not in the end collected in full. Care should however be taken to avoid creating unintended disincentives to making advance commitments, if scoring them as ODA up front crowds out cash outlays today on the part of agencies that are close to their ODA spending limits.

The key in both areas is to incentivise more recourse to innovative risk-mitigation interventions, which do not involve immediate cash outlays, but are likely to be an effective and leveraged use of public finance.

4. Minimise the allocation distortions inherent in international public finance for climate mitigation

4A. Isolate public climate change mitigation finance from country aid budgets and finance it mainly with non-concessional instruments

Comment: Whilst undesirable within a more narrow country-based development approach (because it will create or aggravate allocation distortions, see Section 4) pressures to use development aid budgets for climate change mitigation in developing countries are both politically unavoidable and legitimate. This is both because such funding must be an integral part of a larger global public good solution, and because failure to act globally will ultimately damage development prospects everywhere, even in poorer countries with a very low carbon footprint.

We therefore propose that as a fallback, until major truly additional sources of funding become available, all providers of concessional assistance clearly demarcate the grant element of mitigation-related assistance separately from their country aid budgets. These would continue to contain allocations for climate change adaptation support targeted to the most vulnerable countries, such as LDC and SIDS. Adaptation is at best a national or regional, not global, public good and is inextricably linked to development programmes and to vulnerability, as well as the historical ‘polluter pays’ principle.

Mitigation should also be funded primarily on non-concessional terms at prevailing low real interest rates (taking care not to crowd out the capital needs of MDBs for their other clients and purposes, as discussed above) as the majority of needed investments that may not be funded

on purely commercial terms are in the national as well as global public interest. There should be limited exceptions for applying grant assistance for demonstration activities in LDCs and SIDS (Section 4)

Where possible, the bulk of the residual grant element for mitigation (not necessarily the face value of such loans) should be reserved for LDCs, SIDS and other countries lacking access to capital; this has some overlap with present practice (Section 4), but needs to be monitored carefully in the future, given the sheer scale of mitigation needs as compared to development and adaptation ones.

4B. Establish a new target for the share of concessional assistance for adaptation going to LDCs and SIDS

Comment: A starting point for this discussion could be a minimum share of 50% of climate change adaptation ODA going to these country groups. Intrinsically, most concessional assistance for adaptation should be focused on the most vulnerable countries (such as SIDS and LDCs), as also foreseen, for example, in the Copenhagen Accord. In practice, only some 38% of FSF for adaptation was subsequently so allocated (Section 4), so the 50% target is not as trivial as it may seem. Such a target would also reinforce, indirectly, the UN target of ODA for LDCs as a share of donor incomes (0.15%-0.2%).

Section 7: Concluding remarks: balancing international public-private roles across and within countries

The new normal in the international development community is to emphasise action with the private sector, for example via catalytic deployment of public resources, blended public-private instruments, and public-private partnerships. The private sector consists of a diverse set of actors, including foundations, non-governmental organisations (NGOs), businesses and social impact entrepreneurs. All are far more active development actors than even ten years ago.

We have suggested, in this report, some key areas where this trend can and should be accelerated, notably through the following: guarantees and contingent finance; action to boost the stagnant intermediation capacity of development banks in favour of MICs with restricted market access; action to align private profit-making and social objectives with development objectives; and support of climate change mitigation through loans linked to technology transfer.

However, we should flag some inherent limits to this enthusiasm for the twinning of public and private finance.

Analytically, international public finance, whether counted as aid or not, could be deployed either (a) mainly in countries and sectors where the private sector is not engaged, or, conversely, (b) mainly in those where it is in ever closer association with it. The first approach (after Rogerson, 2014) we might term ‘oil and water’ – keep the aid oil separate from the rest – and the second ‘sugar and water’ – allow the aid sugar to dissolve entirely in a very weak solution.

The number of quintessential ‘oil and water’ countries, where there is simply no alternative, and their populations have shrunk (section 3), and are expected to continue to shrink over time, as proportions of the developing country totals. That trend creates a political economy dilemma, as much more public money, in the pure oil and water paradigm, ends up chasing fewer people, and, to boot, in places with relatively bad track records of using such funding effectively.

Proponents of the first (oil) approach nonetheless see a need to programme the bulk of international public finance budgets separately, to target areas of greatest need and to fill gaps they believe the private sector is not likely to reach, at least in the short and medium terms. They also argue that it is difficult to demonstrate that public support to private investment is actually essential, catalytic, or transformative, and that it is more likely that some of it

will subsidise private schemes that would have happened regardless.

Proponents of the second (sugar) approach point to the leveraging effect of such public support, to its relevance in MICs where most of the world’s poor still live, and to the greater dynamism, creativity and cost-effectiveness of private actors in solving a wide and growing range of development problems, including in the area of ‘public’ services like health and education. They also argue that the slow speed of progress with the first (oil) approach requires a radical departure from ‘business as usual’. And that international public finance can simply displace domestic taxes that could have funded similar items, without the foreign intervention.

In the end, proponents of both approaches are right to some degree. (This black-and-white picture clearly needs to be differentiated by country as well as by sector or thematic focus, and country MDG costing and financing plans need to explore trade-offs, see Section 2).

The bigger practical challenge is that a balance eventually needs to be struck on one side or the other, assuming funding, political support and management capacity are not sufficiently abundant enough to execute both oil and sugar strategies equally well. And they are almost certainly not.

The typical public agency charged with international public finance allocation, still mostly comprising civil servants, probably lacks the capacity to scale up its ‘leveraging’ action very quickly and at the same time continue its public-public line of action. The latter is especially demanding in the case of complex, sensitive and time-consuming efforts towards state-building and the delivery of essential services in the hardest and most fragile contexts. It includes the challenge of actually achieving threshold improvements in rule of law which have wider catalytic effects on the country’s access to private finance (Section 1).

For sure, the public agency can sub-contract the sugar (public-private leveraging) track more and more to semi-private and professional bodies, such as national and international Development Finance Institutions, as many countries are doing. There are, however, significant reputational and fiduciary risks, and potentially high future recurrent costs, inherent in ramping up the blended approach, which the phrase ‘Bureaucrats in Business’,

referring originally to state enterprise management in developing countries, well encapsulates.

We have tried to steer a middle course through this conundrum, reflecting the growing differentiation among developing countries and the growing opportunities for collaboration with the private sector in different contexts.

Our main proposed approach is, in a capsule, to:

- (a) Prioritise international public finance across countries (in grant-equivalent terms) primarily on the basis of their vulnerability, low creditworthiness and lack of fiscal capacity, but then
- (b) *within* these countries, focus efforts as much as possible on *crowding in* other actors, both directly (through blended approaches, contracting services, etc.) and indirectly (by focusing state-building on, in particular, rule-of-law improvements and domestic resource mobilisation likely to expand future access to other sources of finance).
- (c) Expand public non-concessional flows (OF) to thematic areas where substantial private finance can be catalysed, especially in MICs, and incentivise international financial institutions to leverage more private capital through explicit counting of a new category of flows that we call private finance for development.

References

- Alonso, J.A., Glennie, J. and Sumner, A. (2014) 'Recipients and Contributors: Middle income countries and the future of development cooperation'. UNDESA Working Paper No. 135.
- Asiedu, E. (2002) 'On the determinants of Foreign Direct Investment to Developing Countries: Is Africa different?'. *World Development* 30(1): 107-119.
- B20 (2014) 'B20 Infrastructure and Investment Taskforce Policy Summary' July.
- Baudienville, G. (2010) 'Beyond grants: climate finance in developing countries'. ODI Opinion, December.
- Berthélemy, J.C. and Tichit, A. (2002) 'Bilateral Donors' Aid Allocation Decisions: A Three-dimensional Panel Analysis'. Discussion Paper No. 2002/123, UNU-WIDER, December.
- Bhattacharya, A., Romani, M. and Stern, N. (2012) 'Infrastructure for Development: Meeting the challenge'. Policy Paper, Centre for Climate Change Economics and Policy, Grantham Research Institute on Climate Change and the Environment, June.
- Brown J., Bird, N. and Schalteck, L. (2010) 'Climate finance additionality: Emerging definitions and their implications'. Climate Finance Policy Brief No. 2. Overseas Development Institute.
- Calderón, F. et al. (2014) 'Better Growth Better Climate – The New Climate Economy Report'. The Global Commission on the Economy and Climate, September.
- Canuto, O. (2014) 'Liquidity Glut, Infrastructure Finance Drought and Development Banks'. CFI, 19 September 2014, available at: <http://cfi.co/africa/2014/09/liquidity-glut-infrastructure-finance-drought-and-development-banks/>.
- Caruso, R. and Ellis, J. (2013) 'Comparing Definitions and Methods to Estimate Mobilised Climate Finance'. OECD and International Energy Agency, May.
- Clist, P. (2011) '25 Years of Aid Allocation Practice: Comparing Donors and Eras'. Research Paper 09/11, Centre for Research in Economic Development and International Trade, University of Nottingham.
- CPI (2013) 'The Global Landscape of Climate Finance 2013'. Climate Policy Initiative.
- Dell, M., Jones, B. and Olken, B. (2008) 'Climate Change and Economic Growth: Evidence from the Last Half Century'. NBER Working Paper 14132.
- Dell, M., Jones, B. and Olken, B. (2009) 'Temperature and Income: Reconciling New Cross-Sectional and Panel Estimates'. *American Economic Review: Papers and Proceedings* 2009 (2): 198-204.
- Dercon, S. (2014a) 'Is Green Growth Good for the Poor?'. Policy Research Working Paper 6936, Washington, DC.: World Bank.
- Dercon, S. (2014b) 'Climate Change, Green Growth and Aid Allocation to Poor Countries'. Centre for the Study of African Economies (CSAE), Working Paper WPS/2014-24.
- Doucouliaqos, H. and Paldam, M. (2007) 'A meta-analysis of development aid allocation: The effects of income level and population size'. Economics Working Paper 2007-15, School of Economics and Management, University of Aarhus, October.
- Drummond, P. (2012) 'Mobilizing Revenue in Sub-Saharan Africa: Empirical Norms and Key Determinants'. IMF Working Paper 12/108. Washington, DC.: International Monetary Fund.
- EC (2014) 'Banking Union: Restoring Financial Stability in the Eurozone'. European Commission Memo, 15 April.
- Carnahan, M. and Evans, S. (2014) 'Public Goods for Private Jobs: Lessons from Post-conflict Small Island States' (forthcoming).
- Easterly, W. (2006) 'Reliving the 1950s: The Big Push, Poverty Traps, and Takeoffs in Economic Development'. *Journal of Economic Growth*. 11(2):289-318.
- Ellis, J., R. Caruso and S. Ockenden (2013) 'Exploring Climate Finance Effectiveness'. Climate Change Expert Group Paper No. 2013(4), OECD.
- ERD (2015) 'European Report on Development' (forthcoming).
- Ericsson, F. and Steensen, S. (2014) 'Where do we stand on the aid orphans?'. OECD-DAC Development Brief, OECD Development Cooperation Directorate.
- Evaluation of the CIF: 'Independent Evaluation of the Climate Investment Funds'. Meeting of the Joint CTF-SCF Trust Fund Committee, Document CTF-SCF/TFC.12/3.
- Fankhauser, S. and Burton, I. (2011) 'Spending adaptation money wisely'. Centre for Climate Change Economics, Policy Working Paper No. 47 / Grantham Research Institute on Climate Change and the Environment, Working Paper No. 37.
- Fengler, W. and Kharas, H. (2010) 'Delivering Aid Differently'. Brookings Institution Press.
- Foundation Centre (2014) 'Map of International Grants'. Available at: <https://webapps.foundationcenter.org/intl/>
- Freireich, J. and Fulton, K. (2009) 'Investing for Social and Environmental Impact – A design for catalysing an emerging industry'. Monitor Institute, January.
- FT (2014) 'Kenya sees economy grow 25% after statistical revision'. *Financial Times*, 30 September 2014, accessed

- at: <http://www.ft.com/cms/s/0/5cf5ba70-489a-11e4-9d04-00144feab7de.html#axzz3FMaJLuyR>.
- G30 (2013) 'Long-Term Finance and Economic Growth'. Group of Thirty – Working Group on Long-term Finance, Washington, DC.
- Gable, S.; Lofgren, H. and Osorio-Rodarte, I. (2014) 'The post-2015 global agenda : A framework for country diagnostics'. Washington, DC.:World Bank. <http://documents.worldbank.org/curated/en/2014/10/20332904/post-2015-global-agenda-framework-country-diagnostics>
- Galiani et al. (2014) 'The effects of Aid on Growth: evidence from a quasi-experiment'. World Bank Policy Research Working Paper No 6865. Washington, DC.: World Bank.
- Green Climate Fund (2014) 'Initial Results Management Framework of the Fund'. Meeting of the Board, May, Document GCF/B.07/04.
- Greenhill, R., Prizzon, A. and Rogerson, A. (2013) 'The age of choice: how are developing countries managing the new aid landscape?'. London: Overseas Development Institute.
- Gupta, A.S. (2007) 'Determinants of Tax Revenue Efforts in Developing Countries'. IMF Working Paper 07/184. Washington, DC.: International Monetary Fund.
- Hoeffler, A. and Outram, V. (2008) 'Need, Merit or Self-Interest – What Determines the Allocation of Aid?'. Working Paper 2008-19, Centre for the Study of African Economies.
- Jameson, J. and Miyoshi, M. (1998) 'The Cultures of Globalization', Duke University Press.
- IMF (2013) 'Energy Subsidy Reform: Lessons and Implication'. Washington, DC: International Monetary Fund.
- IMF (2014a) 'World Economic Outlook 2014: Recovery Strengthens, Remains Uneven'. Washington, DC.: International Monetary Fund.
- IMF (2014b) 'Global Financial Stability Report: Moving from Liquidity to Growth-Driven Markets'. Washington, DC.: International Monetary Fund.
- IMF and WB (2012) 'Revisiting the Debt Sustainability Framework for Low-Income Countries'. Prepared by the staffs of the International Monetary Fund and World Bank, January.
- Impact Investing, 2014. Available from: <http://www.thegiin.org/cgi-bin/iowa/investing/index.html>. [10 December 2014].
- IPCC (2007) 'IPCC Fourth Assessment Report: Climate Change 2007. Geneva: Intergovernmental Panel on Climate Change.
- Jahjah, S. and Yue, V.Z. (2004) 'Exchange Rate Policy and Sovereign Bond Spreads in Developing Countries'. IMF Working Paper 04/210, November.
- Jones, L. et al. (2012) 'Coding and tracking adaptation finance: Lessons and opportunities for monitoring adaptation finance across international and national scales'. London: Overseas Development Institute.
- Kenny, C. (2011) 'Getting Better'. Basic Books.
- Kenny, C. (2014) 'The Strange and Curious Grip of Country Income Status on Otherwise Smart and Decent People'. CGD Blogpost, Center for Global Development, Washington, DC.; accessed at: <http://www.cgdev.org/blog/strange-and-curious-grip-country-income-status-otherwise-smart-and-decent-people>.
- Kharas, H. (2008) 'Measuring the Cost of Aid Volatility'. Brookings, Working Paper 3, July 2008.
- Kharas, H. (2012), 'Reforming ODA to Increase Development Impact', Briefing Note, July.
- Kharas, H. (2014) 'More and Better Financing for Development'. World Bank Future Development Blog. <http://blogs.worldbank.org/futuredevelopment/more-and-better-financing-development>.
- Kharas, H. (2015) 'Allocating Aid Effectively', The Brookings Institution (forthcoming).
- Kharas, H. and Rogerson, A. (2012) 'Horizon 2025: Creative Destruction in the Aid Industry'. Research Report. London: Overseas Development Institute.
- Kharas, H. and McArthur, J. (2014) 'Mobilizing Private Investment for post-2015 sustainable development', Washington, DC.: The Brookings Institution, available at: <http://www.brookings.edu/research/papers/2014/07/mobilizing-private-investment-post-2015-developmentkharas-mcarthur>
- Kraay, A. and McKenzie, D. (2014) 'Do Poverty Traps Exist? Assessing the Evidence'. Journal of Economic Perspectives 28(3): 127–148.
- Kubzansky, M. (2013) 'Why Business Models Matter'. In Chandy, Kharas, Hosono and Linn (eds.), 'Getting to Scale'. Brookings Press.
- Lagarde, C. (2014) 'Investment for the Future – Higher Investment for Higher Growth'. Speech at Rencontres Economiques d'Aix-en-Provence, 6 July 2014; accessed at: <http://www.imf.org/external/np/speeches/2014/070614.htm>.
- Loayza, N.V., Schmidt-Hebbel, K. and Servén, L. (2000) 'Saving in Developing Countries: An Overview'. World Bank Economic Review 14(3).
- Lundgren, C. , Thomas, A.H. and York, R.C. (2013) 'Boom, Bust or Prosperity? Managing Sub-Saharan Africa's Natural Resource Wealth'. Washington, DC: International Monetary Fund.
- Matovu, J.M., Twimukye, E., Musisi, A. and Levine, S. (2011) 'Assessing Development Strategies to Achieve the MDGs in The Republic of Uganda'. United Nations Department for Social and Economic Affairs', March.
- McKinsey & Company (2009) 'Pathways to a Low-carbon Economy. Version 2 of the Global Greenhouse Gas Abatement Cost Curve'. McKinsey & Company.
- Mitchell, T. and Maxwell, S. (2010) 'Defining climate compatible development'. CDKN Policy Brief.

- Moore, M. (2013) 'Obstacles to Increasing Tax Revenues in Low Income Countries'. Working Paper 15, International Centre for Tax and Development, December.
- Morris, S. (2014) 'Shaking Up the Donor Shakedown at the World Bank'. Center for Global Development Essay, January.
- NAB (2014) 'Private Capital Public Good – How Smart Federal Policy Can Galvanize Impact Investing — and Why It's Urgent'. US National Advisory Board on Impact Investing, June.
- Nakhooda, S. (2014) 'A way forward on climate finance'. Opinion paper. London: Overseas Development Institute.
- Nakhooda, S. et al. (2013) 'Mobilising international climate finance: lessons from the fast-start finance period'. Open Climate Network, November 2013.
- Noy, I. (2009) 'The Macroeconomic Consequences of Disasters.' *Journal of Development Economics* 88: 221-231.
- O'Donohoe, N., Leijonhuvud C. and Saltuk Y. (2010) 'Impact Investments: An Emerging Asset Class'. Global Impact Investing Network and J.P. Morgan, November.
- OECD (2013) 'A Post-2015 Information System for International Development and Climate Finance'. Background Research Paper Submitted to the High Level Panel on the Post-2015 Development Agenda, May.
- OECD (2014) 'OECD CRS table 1a'. Accessed September 2014.
- OECD DAC (2013) 'Initial roadmap for improved DAC measurement and monitoring of external development finance'. OECD Development Assistance Committee, April.
- Raddatz, C. 2009. 'The wrath of God: Macroeconomic costs of natural disasters'. Policy Research Working Paper Series, WPS 5039, Washington, DC.: World Bank.
- Ravallion, M. (2009) 'Do Poorer Countries have less capacity for Redistribution?'. World Bank Policy Research Working Paper 5046, Washington, DC.: World Bank.
- Ravallion, M. (2012) 'Should we care equally about poor people wherever they may live?'. Lets Talk Development blog, 11 August 2012; accessed at: <http://blogs.worldbank.org/developmenttalk/should-we-care-equally-about-poor-people-wherever-they-may-live>.
- Rogerson, A. (2014) 'Water, sugar and oil: How to mix development finance flows to best effect?'. ODI Blog, 12 February 2014. London: Overseas Development Institute; accessed at: <http://www.developmentprogress.org/blog/2014/02/12/water-sugar-and-oil-how-mix-development-finance-flows-best-effect>.
- Roodman, D. (2014) 'Straightening the Measuring Stick: A 14-Point Plan for Reforming the Definition of Official Development Assistance (ODA)'. Policy Paper 044, June 2014, Washington, DC.: Center for Global Development.
- Swart, R. (2008) "Climate change versus development: trade-offs and synergies", Progressive Governance London.
- Sumner, A. (2012) 'Where Do the World's Poor Live? A New Update'. IDS Working Paper Vol 2012 (393).
- Sumner, A. and Tezanos Vázquez, S. (2014) 'How Has the Developing World Changed since the late 1990s? A dynamic and multidimensional taxonomy of developing countries'. Working Paper No. 375, Washington, DC.: Center for Global Development.
- Teulings, C. and Baldwin, R. (2014) 'Secular Stagnation: Facts, Causes and Cures'. Vox e-book. London: Centre for Economic Policy Research (CEPR).
- UNCTAD (2014), World Investment Report, Geneva: UNCTAD.
- UNDP (2013) 'Human Development Report 2013 – The Rise of the South: Human Progress in a Diverse World'. New York: United Nations Development Programme.
- UNEP (2007) 'Global environmental outlook 4: environment for development'. UNEP, Nairobi, Kenya.
- UNEP (2011) 'Towards a Green Economy – Pathways to Sustainable Development and Poverty Eradication'. United Nations Environment Programme.
- UN-HLP (2013) 'The Report of the High-Level Panel of Eminent Persons on the Post-2015 Development Agenda'. New York: United Nations.
- UN-ICESDF (2014) 'Report of the Intergovernmental Committee of Experts on Sustainable Development Financing – Final Draft'. United Nations, 8 August.
- UN-OWG (2014) 'Outcome Document – Open Working Group on Sustainable Development Goals'. United Nations.
- Walsh, J.P. and Yu, J. (2010) 'Determinants of Foreign Direct Investment: A Sectoral and Institutional Approach'. Working Paper 10/187. Washington, DC.: International Monetary Fund.
- Whitley, S. (2013). Time to change: The game fossil fuel subsidies and climate. London: Overseas Development Institute.
- World Bank (2002) 'Global Development Finance: International Capital Flows and Economic Growth'. Washington, DC.: World Bank.
- World Bank WDR (2010a) 'World Development Report 2010 – Development and Climate Change'. Washington, DC.: World Bank.
- World Bank (2010b) 'Economics of Adaptation to Climate Change – Synthesis report'. Washington, DC.: World Bank.
- World Bank (2010c) 'Monitoring Climate Finance and ODA'. Development and Climate Change Report. Washington, DC.: World Bank.
- World Bank (2012) 'Inclusive Green Growth: The Pathway to Sustainable Development'. Washington, DC.: World Bank.

-
- World Bank (2014a) 'Purchasing Power Parities and Real Expenditures of World Economies – Summary of Results and Findings of the 2011 International Comparison Program'. Washington, DC.: World Bank.
- World Bank (2014b) 'Harmonized List of Fragile Situations – FY14'. Washington, DC.: World Bank; accessed at: <http://siteresources.worldbank.org/EXTLICUS/Resources/511777-1269623894864/HarmonizedlistoffragilestatesFY14.pdf>.
- World Bank (2014c) 'How do we classify countries?' available at <http://siteresources.worldbank.org/DATASTATISTICS/Resources/OGHIST.xls>.
- Yellen, J. (2014) 'Monetary Policy and Financial Stability'. The 2014 Michel Camdessus Central Banking Lecture, July 2014; accessed at: <http://www.federalreserve.gov/newsevents/speech/yellen20140702a.html>.

Annex 1: Methodology for analysis of evolution of development finance flows by income per capita

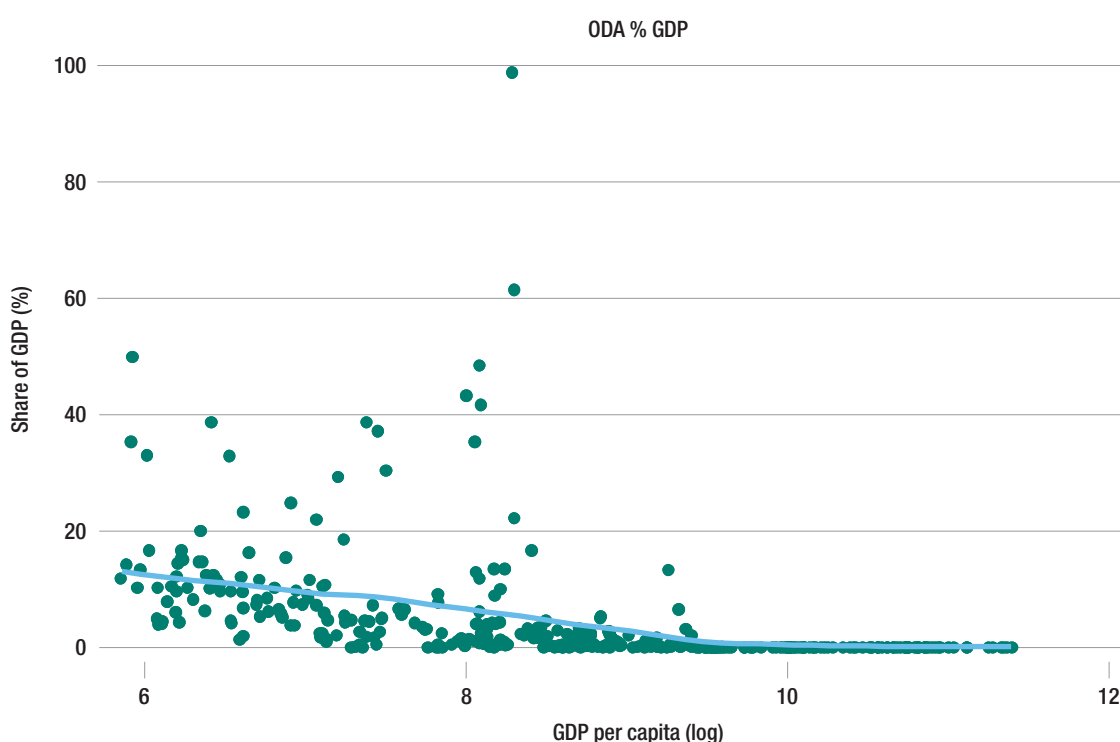
Each horizontal line in Figures A1 to A5 reflects the average value of one of the following financing flows as a share of GDP for the years 2011 and 2012 along the spectrum of per capita GDP in USD (current values; Intratransformation): ODA flows (net ODA – grants and loans) and OOF (net) both from OECD.Stat; net FDI inflows (World Bank World Development Indicators); net workers' remittances received (World Bank World Development Indicators), and tax revenues (World Bank World Development Indicators).

For example, data points corresponding to per capita income – let's say of \$1,000 – are average values for all the countries in 2011 and 2012 whose per capita

income was at \$1,000. The same logic applies to all levels of per capita GDP. For the sake of clarity, the figures omit the distribution for each flow around its mean. ERD (forthcoming 2015) takes a different perspective, considering long-term trends since 1990.

We use a local polynomial smoothing technique for each variable (Epanechnikov function). Results are robust, also taking a longer-term perspective (since 1990). The curve reflecting total flows in each graph follows the same methodology and it is not the sum of each flow depicted in the graph but the polynomial smoothed line of total flows for each country.

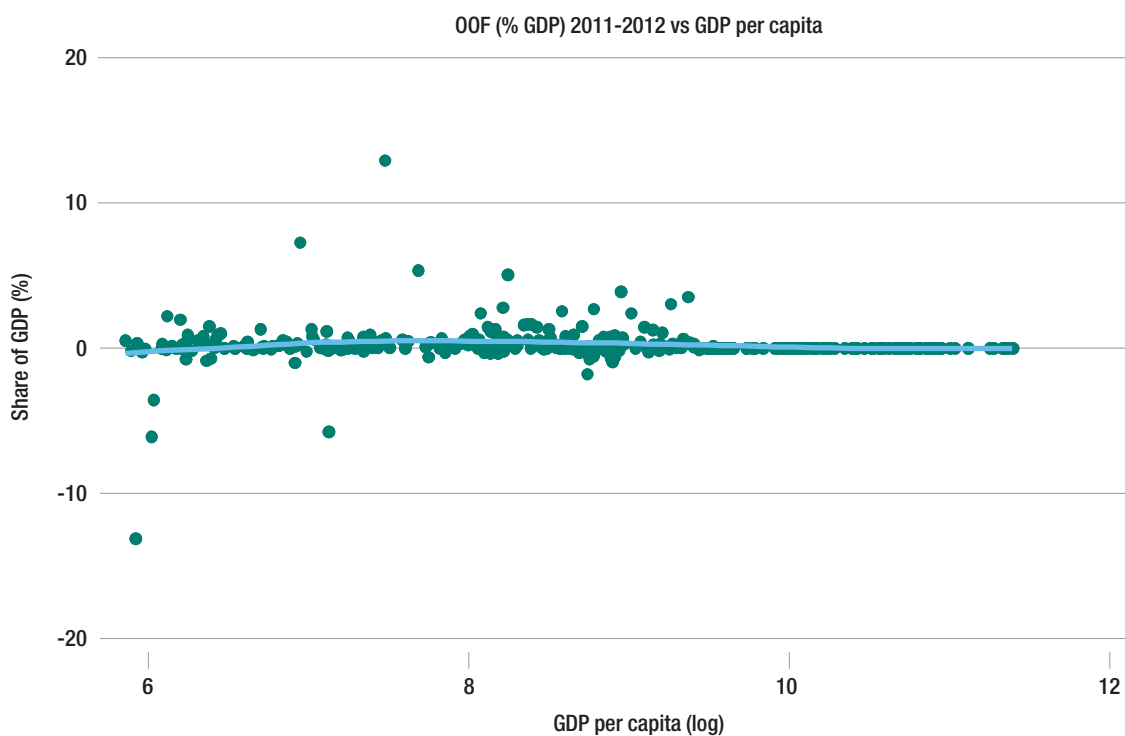
Figure A 1. ODA Official Development Assistance vs GDP per capita



Source: World Development Indicators and OECD.stat.

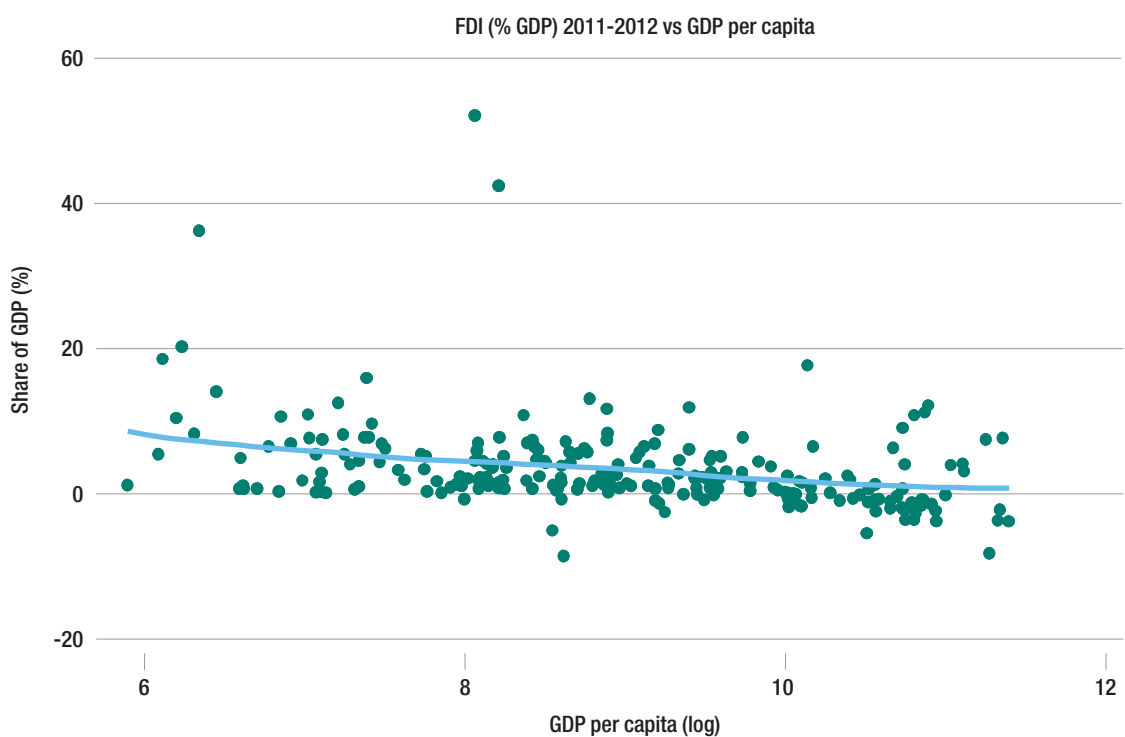
Note: We included countries whose annual income per capita was above \$350 (because of data availability on Tax Revenues) and below \$90,000. Outliers for 2011 and 2012 for FDI flows (Mauritius and Iceland) were omitted from the analysis. We also excluded countries whose tax revenue to GDP ratio was reported to be below 1% (Kuwait and United Arab Emirates).

Figure A 2. Comparison other official flows and GDP per capita



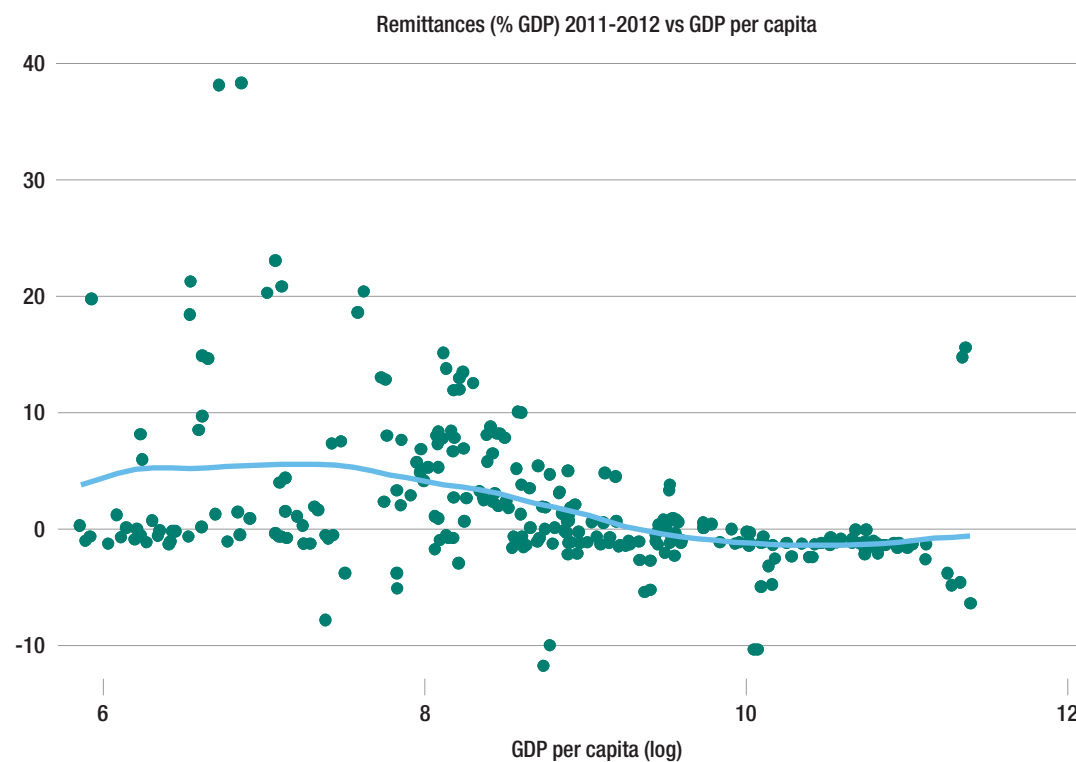
Source: OECD.Stat and World Development Indicators.

Figure A 3. Comparison foreign direct investment and GDP per capita



Source: World Development Indicators.

Figure A 4. Comparison remittances and GDP per capita



Source: World Development Indicators.

Figure A 5. Comparison tax revenues and GDP per capita



Source: World Development Indicators.

Annex 2: Methodology for Market Aid Index

The Market Aid Index is based on analysis for a range of OECD countries of (1) the share of their ODA focused on private sector development and (2) the share of their total official flows (ODA plus OOF) which consists of OOF. Background/definitional issues and methodological approaches for utilising these two categories of aid flows are presented below:

i) Share of ODA focused on private sector development

The OECD's Creditor Reporting system (CRS) for monitoring the use of ODA does not include a category 'private sector development', and therefore this category was approximated based on selecting the ODA sector categories which are most relevant. We selected the following CRS sector categories to include under our 'private sector development' category based on the fact that the private sector could reasonably be expected to be the leading actor or main partner for ODA in these sectors:

Economic infrastructure and services (sector code 200)

- Transport and storage (210) – all sub-sectors except transport policy and admin (21010), road transport (21020) and education/training in transport and storage (21081)
- Communications (220) – all sub-sectors except communications policy and admin (22010)
- Energy (230) – all sub-sectors except energy policy and admin (23010), energy education/training (23081) and energy research (23082)
- Banking and financial services (240) – all sub-sectors except financial policy and admin (24010), monetary institutions (24020) and education/training in banking and financial services (24081)
- Business support services and institutions (250) – all sub-sectors

Production sectors (sector code 300)

- Agriculture (311) – all sub-sectors except agricultural policy and admin management (31110), agricultural extension (31166), agricultural education/training (31181) and agricultural research (31182)
- Forestry (312) – all sub-sectors except forestry policy and admin management (31210), forestry education/training (31281) and forestry research (31282)
- Fishing (313) – all sub-sectors except fishing policy and admin management (31310), fishery education/training (31381) and fishery research (31382)

- Industry (321) – all sub-sectors except industrial policy and admin management (32110) and technological research and development (32182)
- Mineral resources and mining (322) – all sub-sectors except mineral/mining policy and admin management (32210)
- Trade policies and regulations (331) – all sub-sectors
- Tourism (332) – all sub-sectors

CALCULATING THE FIGURE FOR THE INDEX – On this basis the aggregate figure was then calculated for **gross ODA to the private sector during 2009-2012** for each OECD country, and then **divided by total gross ODA during 2009-2012** from each OECD country. This results in a score of from 0 to 1 (which could be multiplied by 100 to produce a percentage figure) for each OECD country.

ii) Share of OOF in total official flows (ODA plus OOF)

OOFs are defined as 'transactions by the official sector with countries on the List of Aid Recipients which do not meet the conditions for eligibility as ODA or Official Aid.' We utilised this category of flows as the numerator for the second part of our catalytic index on the basis of assuming that OOF are mainly provided to/utilised in cooperation with the private sector.

The data for OOF were collected from the OECD's database on these flows. It should be noted, however, that this source does not capture all OOF from OECD countries to developing countries, as not all relevant institutions providing such assistance report their data to the OECD, and the data also do not accurately reflect the shares of flows from multilateral development finance institutions that can be attributed to the support of OECD Governments.

CALCULATING THE FIGURE FOR THE INDEX – The aggregate figure was calculated for **gross OOF during 2009-2012** for each OECD country, and then divided by total official flows – ODA + OOF during 2009-2012 – from each OECD country. This results in a score from 0 and 1 (which could be multiplied by 100 to produce a percentage figure) for each OECD country. Table A 1 reports the actual shares for both components.

Table A 1. Share of ODA to the private sector and OOF as a share of total official finance

	Share of ODA to the private sector (%)	OOF as share of OF(%)
Australia	4.8	8.3
Austria	8.8	25.0
Belgium	15.9	4.1
Canada	10.9	55.2
Denmark	13.4	1.9
Finland	13.4	28.1
France	11.4	10.6
Germany	25.3	13.0
Greece	1.2	0.0
Ireland	8.3	0.0
Italy	9.2	9.2
Japan	30.8	43.0
Republic of South Korea	21.2	81.3
Luxembourg	7.5	0.0
Netherlands	11.5	0.0
New Zealand	16.1	3.0
Norway	12.4	0.0
Portugal	6.2	0.1
Spain	18.4	0.1
Sweden	7.7	1.3
Switzerland	8.6	0.0
United Kingdom	11.5	0.3
United States	8.2	9.7

Source: Authors' elaboration on the basis of OECD (2014).

Producing the final index

The final index for each OECD country was then produced by normalising and summing their score for each category of flows. These normalised figures were produced by utilising the following formula:

$$\frac{X - X_{\min}}{X_{\max} - X_{\min}}$$

where X is the actual value for the OECD country, and X min and X max the minimum and maximum value for OECD countries for that component.

Note: It had been hoped to include recently compiled data from the OECD on the flows to/in developing countries mobilised by their members from guarantees for the private sector as a third element of this index. However, the process and methodology for gathering this data was only recently utilised for the first time, and from reviewing the results there seem to be some very significant gaps in the data. It was therefore decided not to include them in this version of the catalytic aid index, but it would be valuable to include them in any future iterations.

Annex 3: Marginal tax rates

Marginal tax rates are based on \$1.25 PPP/day poverty gap. The methodology is based on Ravallion (2009).

Table A 2. Marginal tax rates

Country	Survey year	Inc/Con	Mean (\$)	Pov. gap (1.25\$) %	Pov. gap (\$13) %	Marginal tax rate
Albania	2012	C	181.78	0.1	55.39	0.71
Algeria	1995	C	122.25	1.27	69.6	23.63
Angola	2008.5	C	59.84	16.45	84.94	100.00
Argentina--Urban	2011	I	466.64	0.78	25.96	0.17
Armenia	2012	C	118.7	0.31	70.7	4.15
Azerbaijan	2008	C	214.04	0.12	50.38	0.26
Bangladesh	2010	C	51.67	11.17	86.97	100.00
Belarus	2011	C	508.81	0	9.89	0.00
Belize	1999	I	191.4	5.52	62.11	5.05
Benin	2011.5	C	54.68	18.82	86.41	100.00
Bhutan	2012	C	154.55	0.37	63.86	1.21
Bolivia	2012	I	276.25	4.2	45.4	2.65
Bosnia and Herzegovina	2007	C	521.89	0.01	14.08	0.00
Botswana	2009.3	C	225.72	3.95	61.4	2.05
Brazil	2012	I	418.24	2.14	36.26	0.49
Bulgaria	2011	I	329.77	0.81	31.21	0.53
Burkina Faso	2009	C	56.28	14.59	86.12	100.00
Burundi	2006	C	28.96	36.39	100	47.78
Cambodia	2011	C	84.4	1.43	78.98	42.36
Cameroon	2007	C	79.73	7.24	80.15	100.00
Cape Verde	2007.5	C	115.72	3.18	73.02	13.38
Central African Republic	2008	C	51.28	31.26	89.03	100.00
Chad	2011	C	67.79	14.18	83.1	100.00
Chile	2011	I	513.41	0.38	28.21	0.06
China	2010	C	160.16	2.03	63.27	5.17
Colombia	2012	I	308.7	2.33	47.11	0.89
Comoros	2004	C	94.4	20.82	83.01	29.08
Congo, Dem. Rep.	2005.5	C	21.74	52.76	100	92.27
Congo, Rep.	2011	C	69.57	11.47	82.74	100.00
Costa Rica	2012	I	493.21	0.58	28.21	0.11
Croatia	2008	C	671.62	0	6.8	0.00
Czech Republic	2011	I	680.73	0.06	4.1	0.01
Côte d'Ivoire	2008	C	70.82	12.68	82.4	100.00
Djibouti	2002	C	93.52	5.29	77.04	73.61

Country	Survey year	Inc/Con	Mean (\$)	Pov. gap (1.25\$) %	Pov. gap (\$13) %	Marginal tax rate
Dominican Republic	2012	I	247.32	0.6	50.28	0.45
Ecuador	2012	I	287.54	1.8	44.8	0.99
Egypt, Arab Rep.	2008.3	C	114.02	0.37	72.46	2.75
El Salvador	2012	I	216.37	0.56	53.06	0.69
Estonia	2011	I	539.42	1.18	12.44	0.23
Ethiopia	2010.5	C	55.44	10.39	86.24	100.00
Fiji	2008.5	C	141.01	1.14	68.2	2.84
Gabon	2005	C	150.22	1.25	65.55	3.39
Gambia, The	2003	C	81.89	11.69	80.42	99.49
Georgia	2012	C	115.68	4.53	71.97	35.55
Ghana	2005.5	C	80.25	9.88	80.3	100.00
Guatemala	2011	I	156.75	4.78	67.51	6.43
Guinea-Bissau	2002	C	48.38	16.55	87.77	100.00
Guinea	2012	C	52.83	12.7	100	9.14
Guyana	1998	I	180.14	2.77	60.26	4.58
Haiti	2001	I	55.53	32.31	87.16	100.00
Honduras	2011	I	189.7	7.21	63.95	5.81
Hungary	2011	I	443.42	0.05	15.8	0.02
India	2009.5	C	60.34	7.49	85.03	100.00
Indonesia	2010	C	82.77	3.28	88.75	3.26
Iran, Islamic Rep.	2005	C	197.67	0.34	54.9	0.67
Iraq	2012	C	105.96	0.64	73.4	31.23
Jamaica	2004	C	274.33	0.02	46.57	0.01
Jordan	2010	C	214.31	0.02	50.82	0.04
Kazakhstan	2010	C	215.31	0.01	48.6	0.03
Kenya	2005.4	C	65.47	16.91	84.54	100.00
Kyrgyz Republic	2011	C	116.34	1.18	71.11	21.32
Lao PDR	2012	C	66.18	7.66	83.6	100.00
Latvia	2011	I	426.08	0.95	22.48	0.30
Lesotho	2010	C	54.89	29.17	86.53	100.00
Liberia	2007	C	27.14	40.9	93.25	100.00
Lithuania	2011	I	447.92	0.81	18.47	0.25
Macedonia, FYR	2008	C	295.42	0.04	42.85	0.02
Madagascar	2010	C	23.64	48.55	94.08	100.00
Malawi	2010.2	C	37.01	34.25	91.16	100.00
Malaysia	2009	I	399.76	0	33.32	0.00
Maldives	2004	C	176.47	0.14	58.11	0.49
Mali	2010	C	46.32	16.45	100	13.50
Marshall Islands	1999	C	n/a	n/a	n/a	
Mauritania	2008	C	84.37	6.79	79.34	96.44
Mexico	2012	C	336.59	0.23	40.99	0.08

Country	Survey year	Inc/Con	Mean (\$)	Pov. gap (1.25\$) %	Pov. gap (\$13) %	Marginal tax rate
Micronesia, Fed. Sts. – urban	2000	I	142.46	16.32	71.31	21.39
Moldova, Rep.	2011	C	191.28	0.03	54.01	0.12
Mongolia	2007.5	C	n/a	n/a	n/a	
Montenegro	2011	C	291.1	0.08	35.22	0.09
Morocco	2007	C	160.43	0.55	63.86	1.19
Mozambique	2008.6	C	45.59	25.84	89.31	100.00
Namibia	2009.5	C	162.68	5.74	70.51	4.74
Nepal	2010.2	C	69.31	5.21	82.49	100.00
Nicaragua	2009	C	167.65	2.93	62.83	5.39
Niger	2011	C	51.98	10.42	86.9	100.00
Nigeria	2009.8	C	42.03	27.46	89.38	100.00
Pakistan	2010.5	C	73.26	1.94	81.73	72.50
Panama	2012	I	421.48	1.28	35.6	0.29
Papua New Guinea	1996	C	86.56	12.28	80.18	57.02
Paraguay	2012	I	329.22	0.96	40.75	0.38
Peru	2012	I	322.04	0.78	39.62	0.36
Philippines	2012	C	103.18	4.02	75	35.33
Poland	2011	C	374.06	0	25.56	0.00
Romania	2012	C	215.85	0	47.29	0.00
Russian Federation	2009	C	444.8	0.01	24.26	0.00
Rwanda	2010.8	C	50.3	26.53	100	20.05
Senegal	2011	C	67.97	11.08	82.99	100.00
Serbia	2010	C	303.08	0	32.65	0.00
Seychelles	2006.5	C	465.8	0.07	44.27	0.01
Sierra Leone	2011	C	44.35	19.24	88.8	100.00
Slovak Republic	2011	I	702.93	0.19	4.85	0.02
Slovenia	2011	I	918.2	0	1.27	0.00
South Africa	2010.7	C	319.6	1.19	55.71	0.31
Sri Lanka	2009.5	C	117.66	0.65	71.79	4.04
St. Lucia	1995	I	98.52	7.2	76.09	68.85
Sudan	2009	C	81.58	5.46	79.39	100.00
Suriname	1999	I	186.13	5.9	62.03	6.23
Swaziland	2009.5	C	82.44	15.22	80.49	100.00
Syrian Arab Republic	2004	C	135.38	0.2	67.38	1.19
São Tomé and Príncipe	2010	C	51.39	13.94	100	10.31
Tajikistan	2009.1	C	94.83	1.36	76.1	100.00
Tanzania	2011.8	C	55.91	12.98	86.17	100.00
Thailand	2010	C	228.19	0.04	50.26	0.05
Timor-Leste	2007	C	55.63	8.14	100	5.56
Togo	2011	C	53.76	22.52	86.43	100.00
Trinidad and Tobago	1992	I	186.26	1.05	57.16	2.37

Country	Survey year	Inc/Con	Mean (\$)	Pov. gap (1.25\$) %	Pov. gap (\$13) %	Marginal tax rate
Tunisia	2010.4	C	228.04	0.2	48.05	0.34
Turkey	2011	C	344.16	0	34.01	0.00
Turkmenistan	1998	C	83.52	6.97	79.36	100.00
Uganda	2012.5	C	70.79	11.96	82.91	100.00
Ukraine	2010	C	320.13	0	27.56	0.00
Uruguay	2012	I	489.53	0.09	22.86	0.02
Uzbekistan	2003	C	n/a	n/a	n/a	
Venezuela, RB	2006	I	219.19	3.74	53.04	4.24
Vietnam	2012	C	154.78	0.55	62.78	2.75
West Bank and Gaza	2009	C	304.1	0.01	35.87	0.01
Yemen, Rep.	2005	C	93.94	1.87	77.44	15.02
Zambia	2010	C	38.96	41.78	91.21	100.00

Source: Authors' elaboration based on PovCal and World Bank World Development Indicators. Poverty data released by World Bank in October 2014.

Note: Figures for Angola, Gambia, Guinea Bissau, Guyana, Morocco and Yemen have changed once compared to Ravallion (2009) even though there is no more updated survey: latest data on Povcal (October 2014) on poverty gap and mean income differ from Ravallion (2009).

Endnotes

- 1 See e.g. UN-HLP, 2013; UN-OWG, 2014; UN-ICESDF, 2014; Calderón et al., 2014; and ERD, 2015 (forthcoming).
- 2 Assumes nominal growth of GDP of 5% for developing countries on average. The steady-state level of debt/GDP of 60% is consistent with the Maastricht criterion used for European countries.
- 3 Information about MAMS can be found at <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTDECPROSPECTS/0,,contentMDK:21403964~menuPK:4800417~pagePK:64165401~piPK:64165026~theSitePK:476883,00.html>.
- 4 <http://www.nytimes.com/2014/07/15/world/asia/poor-sanitation-in-india-may-afflict-well-fed-children-with-malnutrition.html?>
- 5 Guarantees for Development, OECD, March 2014. <http://www.oecd.org/dac/externalfinancingfordevelopment/documentupload/GURANTEES%20report%20FOUR%20PAGER%20Final%2010%20Mar%2014.pdf>
- 6 Using coefficient of variation (standard deviation divided by mean).
- 7 We use OOFs as a proxy for official flows beyond ODA focused on private sector and catalytic financing as such flows are commonly provided through the private-sector oriented arms of the development finance institutions and use catalytic instruments.

Data on OOFs was accessed from the OECD's DAC table 2b; it is important to note that this data set is incomplete as not all relevant agencies from OECD countries report their OOFs to the OECD and these figures also don't reflect multilateral OOFs that could be attributed to the bilateral agencies funding them; as a result the OOFs, index scores should be viewed with some caution.
- 8 Since 1987, when the distinction between LMIC and UMIC was introduced, several countries moved up or down each year. Before 2000, 50% of the countries changing their income category were moving down; as a consequence of stronger growth performance, this share fell to 15% in the 2000s.
- 9 This figure excludes Kenya, which reached the LMIC threshold in late September 2014 (see FT, 2014).
- 10 Since 1987 when the distinction between LMIC and UMIC was introduced, several countries have moved up or down each year. Before 2000 50% of the countries changing their income category were moving down; as a consequence of stronger growth performance, this share fell to 15% in the 2000s.
- 11 See Sumner, 2012; Ravallion, 2012; Alonso, Glennie and Sumner, 2014; Kenny, 2014; Sumner and Tezanos Vázquez, 2014, among others.
- 12 70% for Ghana in 2011 – price levels had not been updated since 1993 – and 89% for Nigeria in 2013, with prices still based on 1990 figures.
- 13 The mix between grants and concessional loans is determined by the risk of debt distress of the country (IMF and WB, 2012).
- 14 These trends are consistent with the findings of the literature so far. First, tax revenues have been found to be positively associated with rising per capita income (Gupta, 2007; Drummond, 2012; Moore, 2013); and most of the literature finds aid flows from traditional donors being negatively correlated to per capita income (Hoeffler and Outram, 2008; Doucouliagos and Paldam, 2007; Berthélemy and Tichit, 2002; Clist, 2011). As per Figure 4, there is a positive relationship between income per capita level and FDI/GDP ratio, but the literature has identified mixed evidence so far (see Walsh and Yu (2010) and Asiedu (2002) for Sub-Saharan countries).
- 15 Fragile countries refers here to the World Bank Harmonized List of Fragile Situations FY / 14 (World Bank, 2014b).
- 16 13.8 % of GDP average for fragile countries, 8% for non-fragile countries.
- 17 8% of GDP average for fragile countries, 3.9% for non-fragile countries.
- 18 The other exception is the distribution of tax ratios according to income classification and HDI.
- 19 Ravallion (2009) estimates that the marginal tax rate would be 100% (so no capacity for redistribution) for an annual income below \$2,000 PPP; for income greater than \$4,000 PPP the marginal tax ratio becomes small (1%).
- 20 Negotiations have recently accelerated, and in May 2014 delegates finally agreed on procedures to operationalise the Green Climate Fund after stalled negotiations.
- 21 Some argue there is no substantial evidence that the greening of economies inhibits either wealth creation or employment opportunities (UNEP, 2011). A green investment scenario of 2% of global GDP delivers long-term growth over 2011-2050 that is at least as high as an optimistic business-as-usual case, while avoiding considerable downside risks such as the effects of climate change, greater water scarcity, and the loss of ecosystem services (UNEP, 2011, pp.23-24).
- 22 World Bank (2012a) argues that many capital investments for climate change mitigation will be recouped through subsequent savings. Globally, \$1 spent on energy efficiency would save \$2 through investment in new supply, with the savings being even greater in developing countries.
- 23 The Global Environment Facility (GEF) and the Adaptation Fund have not yet done impact assessment of their projects because they are only at mid-term stage and because of the complexity of the task. Climate Investment Funds (CIF) is at the early stage of disbursement.
- 24 The residual 21% refers to Reduced Emissions from Deforestation and Forest Degradation (REDD+) projects (10%), projects with multiple objectives (9%) and not assigned (2%).
- 25 On the issues related to definition and measurement of additionality see also Brown et al. (2010); World Bank (2012c) and Nakhlooda et al. (2013).
- 26 IMF World Economic Outlook database.

-
- 27 In the case of Uganda, for example, it has not used its IDA allocation entirely, but was instead preparing for Eurobond issuance. Ghana, which issued such bonds in 2013, has chosen to delay IDA and African Development Fund credits. In the case of IBRD-eligible countries, as country borrowing limits are not published, it is hard to establish where they, as against political lack of demand or insufficient project processing capacity, are binding.
- 28 \$16.6 billion, including the additional \$2.5 billion committed and scheduled, but not yet paid, under the recent five-year capital increase window. \$14 billion was paid in as of 30 June 30 2014 (WB Treasury website).
- 29 A variety of technical proposals (Kharas, 2012; Roodman, 2014; OECD DAC, 2013) exists for such a change. The current definition is problematic both because of the fixed 10% discounting method used and because of its arbitrary threshold of a minimum 25% grant element, encouraging the hardest possible loan terms that just pass that arbitrary test. Recognising the grant element alone removes this bias, regardless of the discount rate adopted.
- 30 The European Commission's state aid rules, for example, assess guarantees as an effective upfront subsidy worth 10%-20% of the nominal amounts covered, depending on risk category. Current DAC technical proposals lean towards making guarantees a memo item separate from ODA.

ODI is the UK's leading independent think tank on international development and humanitarian issues. Further ODI materials are available at odi.org.uk

This publication is based on research funded by the Bill & Melinda Gates Foundation. The findings and conclusions contained within are those of the authors and do not necessarily reflect positions or policies of the Bill & Melinda Gates Foundation.



Overseas Development Institute
203 Blackfriars Road
London SE1 8NJ

Tel: +44 (0)20 7922 0300
Email: odi@odi.org.uk

facebook.com/odi.development

Designed by Ranch, www.ranchdesign.co.uk

odi.org